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Politics this week

Oct 25th 2001
From The Economist print edition

Air raids

America's **war against terrorism** seemed to enter a new phase after details were released of a raid by airborne forces on a target inside Afghanistan, though expected follow-up attacks did not materialise. Air raids on the country continued: Taliban spokesmen claimed many civilian casualties. America admitted that some “collateral damage” may have occurred.

See article: Fighting terrorism

More anthrax

Two Washington postal workers, from the office that handled the contaminated letter sent to Tom Daschle, the Senate majority leader, died from inhalation **anthrax**, the most deadly form of the disease. Several other workers from the same office were suspected of having the disease, as was a worker from a sorting office in Trenton, New Jersey. Mass testing of postal workers began in Washington, DC, New Jersey and New York.

Reuters

See article: Coping with the anthrax outbreak

Anthrax spores were also found in a military building that handles mail addressed to the **White House**. John Potter, the postmaster-general, said he could not guarantee that any American mail was safe.

See article: The postal service's troubles

Canada relented after threatening to circumvent a patent on Cipro, an antibiotic for the treatment of **anthrax**, and obtain supplies from a generic-drug company. Bayer, Cipro's maker, agreed to provide as much of the drug as Canada needed to allay public fears. The United States threatened to override the patent if Bayer did not drop its prices—which it then did.

See article: Patents, anthrax and antibiotics

The House of Representatives approved the president's **anti-terrorism** measures, which will now be taken up by the Senate.

Israel defiant

In a ferocious week-long assault that claimed more than 40 Palestinian lives, **Israeli tanks and infantry** reoccupied parts of six Palestinian-controlled cities. The declared aim was to arrest militants, including the group that killed an Israeli minister last week. America brusquely demanded that the tanks be withdrawn. The Israelis took their time.

See article: Pull back the tanks, says Bush to Sharon

After militants in central **Nigeria** killed 19 soldiers, armed men in civilian clothing attacked four villages, killing some 200 people. The army denied responsibility. Renegade soldiers are suspected.

A group of Commonwealth ministers visited **Zimbabwe** to investigate whether the government had acted on promises, made last month at a meeting in Nigeria, to end farm invasions and restore the rule of law. Few expected them to come up with a positive answer. Amnesty International reported that government-backed murders were increasing.

A **South African mob** attacked hundreds of Zimbabwean immigrants living in shacks near Johannesburg, accusing them of stealing jobs, and of various crimes. Hostility towards Zimbabweans has been rising across the country.

The fatal shore

At least 350 people, mostly Iraqi **asylum-seekers**, died when their overladen boat sank after leaving Indonesia bound for Australia. Australia said it had identified an Egyptian in Jakarta who had organised the voyage.

Thirteen people died in shooting incidents in Indian **Kashmir**, bringing to at least 150 the toll since militant protest flared after America started bombing Afghanistan. In a separate development, 20 Pakistanis training in Afghanistan for operations in Kashmir were reported killed by American bombs.

Innocent and guilty

Under heavy pressure from America and its own political wing, the **Provisional** (ie, mainstream) **IRA** began putting some of its weapons “beyond use”. No details or numbers, but Northern Ireland's first minister, David Trimble, gave the news a hearty welcome.

See article: The IRA has put the peace process back on track

Britain's government eased the country's **drug laws**. Possessing small amounts of cannabis will no longer result in arrest and medicinal use is likely to be sanctioned.

See article: Britain's liberties

AP

Italy's final appeals court cleared the prime minister, **Silvio Berlusconi**, of involvement in bribing tax inspectors dealing with three companies in his Fininvest group. However, the court found several Fininvest managers guilty for their role in the bribery.

In **Berlin**, the Democratic Socialists—heirs of the communists who ran East Germany for the Russians—took 23% of the vote in the election for a new state administration.

See article: Ex-communists near power in Berlin

Macedonia's official police began patrolling areas formerly controlled by ethnic-Albanian guerrillas. Hardly had they left one village than its police station was blown up. Bad news for the peace deal, still not put into law by the parliament.

See article: A bombshell in Macedonia

In Galicia, Spain's north-western province, over 50% of the vote in a regional election went to the governing People's Party, ensuring a fourth consecutive term as premier for its leader, **Manuel Fraga**.

See article: Charlemagne: Manuel Fraga, premier of Galicia

Two trucks crashed head-on and caught fire in **Switzerland's** St Gotthard road tunnel. Ten people died and more than 80 are still missing.

Swap or default?

Domingo Cavallo, **Argentina's** economy minister, made an unannounced visit to New York, apparently to try to persuade bankers of the virtues of a debt swap that rating agencies say may amount to a default. The government held back planned economic measures, after talks with provincial governors over budget cuts dragged on.

After 30 years of debate, **Mexico's** transport ministry at last decided on the site for a new international airport for Mexico city. It will be built on the dried-up bed of Lake Texcoco. The city's mayor said he would challenge the decision in the courts.

See article: Mexico's overdue new airport

A leading human-rights lawyer was murdered in **Mexico**. Investigators suspected the army of being behind her death.

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Business this week

Oct 25th 2001
From The Economist print edition

Staying aloft

Switzerland's federal government, some cantons and some of the country's biggest companies—including Nestlé, Novartis, UBS and Credit Suisse—decided that a national airline was required irrespective of cost. Although most national airlines look in a sorry state, government and business stumped up SFr4.24 billion ($2.6 billion) to recapitalise Crossair, a Swiss regional airline that will take over two-thirds of bankrupt Swissair's aircraft and routes.

See article: Europe's airlines and subsidies

Britain and America resumed talks aimed at an "**open skies**" agreement that would allow more airlines to ply their trade between the two countries, and would persuade America's antitrust authorities to allow an alliance between BA and American Airlines. The French government confirmed a similar deal to enable an alliance between Air France and Delta. BA also began alliance talks with KLM Royal Dutch; other European airlines are likely to seek allies.

America's bad results

America's biggest companies had a tough week. **AMR**, parent company of American Airlines, the world's biggest, reported a loss of $525m in the latest quarter, including losses related to September 11th, compared with a profit of $322m last year.

Viacom, an American media giant that owns CBS, MTV and Paramount Pictures among others, announced a net loss of $190m in the third quarter, partly as a result of lost advertising revenue after September 11th.

See article: Media and the economic downturn

Lucent Technologies, an American telecoms-equipment maker, reported losses in the latest quarter of $8.8 billion compared with $484m in the same period last year. Much of the loss is accounted for by restructuring costs that will see its workforce reduced by almost half, to as few as 57,000 by March next year.

Honeywell lost $308m in the third quarter after restructuring costs of $1 billion. It also said 4,100 jobs would go next year in addition to 15,800 announced in September.

Xerox announced a fifth consecutive quarterly loss, of $211m, slightly more than a year ago. The copier company has spent some years in the doldrums and claimed that a restructuring plan had been put back by the aftermath of September 11th.

Profits at **ExxonMobil**, the world's biggest publicly-traded oil company, fell by 23% in the third quarter, to $3.3 billion, compared with the same period the year before when the company made the highest profits ever recorded by an American company. Falling oil prices are largely to blame.

Enron's share price suffered a second blow a week after its third-quarter results showed a one-off charge of $1 billion related to investments that had gone awry. Investors took further fright after the energy-trading giant admitted that one of the deals, involving its chief financial officer, Andrew Fastow,

had caught the eye of America's Securities and Exchange Commission, which then started an informal investigation of Enron. Mr Fastow is being replaced.

America's International Trade Commission agreed with the country's **steel** companies that foreign competition was adversely affecting domestic producers. This opens the way for the government to introduce tariffs and quotas on foreign steel. The European Union threatened action through the WTO if restrictions were introduced.

Sent packing?

It was reported that the European Commission would block a *euro*1.7 billion ($1.5 billion) purchase by France's **Tetra Laval** of a rival Swedish packaging company, **Sidel**. The Commission fears for competition in the drinks-packaging market.

America's Federal Trade Commission voted to block the $8.2 billion sale of **Seagram's** drink businesses to **Diageo**, a British drink company, fearing that it would create a rum duopoly with Bacardi. Diageo said it would give up the Malibu rum brand to prevent the deal from being beached.

Germany's Ifo business-climate index plummeted to its lowest level since 1993 and its biggest monthly fall since 1973—worrying signs that Europe's largest economy is leading the way toward recession.

See article: Germany's troubled economy

Japan's losses

Fujitsu announced losses of ¥175 billion ($1.4 billion) in the six months to September. The Japanese electronics giant suffered from the falling demand for chips and telecoms equipment. The company added a further 4,500 job losses to the 16,400 announced in August.

Sony, another Japanese electronics giant, reported a second quarterly loss, of ¥13.2 billion ($111m), in the three months to September. Weaker consumer demand has hit sales in America. However, the company's game division moved back into profit, thanks to rising sales of PlayStation2.

Japan's economics minister, Heizo Takenaka, said that **redenominating the yen** was again under consideration as part of wider economic restructuring; removing two noughts would bring it into line with the dollar and euro. The measure is more usually associated with countries that are suffering hyperinflation to restore confidence; deflation-stricken Japan would perhaps be better advised to add some zeroes.

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The world since September 11th

How the world has (and hasn't) changed

Oct 25th 2001
From The Economist print edition

Remember September 10th?

ON SEPTEMBER 11th, when millions around the world watched with astonishment and horror as two hijacked aircraft flew into the World Trade Centre and another into the Pentagon, the world suddenly seemed completely different. Such an event may not have been unimaginable—something like it had been included in umpteen academic and military think-pieces about future threats—but it was unexpected, and deeply shocking. It was a declaration of war by act if not in words, and a war has indeed ensued, with air strikes beginning in Afghanistan on October 7th and bioterrorism attacks being discovered in America at around the same time. To that extent, the first reaction was correct: the world has changed. But what of deeper, or at least longer-term, changes?

The plainest answer to that question is that much depends on how the war proceeds. Barely three weeks after the bombing began, the campaign is merely in its early stages. So far, it is more striking how little has happened in the war than how much, in one good sense and one potentially worrying one. The good sense is that Osama bin Laden's hope that war in Afghanistan would radicalise millions of Muslims has not yet been fulfilled. The potential worry, which may be premature or just blinded by this especially foggy war, is that America has not yet shown signs of a willingness to risk casualties among its own soldiers in the cause of unseating the Taliban regime or catching Mr bin Laden and his al-Qaeda terrorists. The bombing has weakened the Taliban, but neither America nor its Afghan allies-of-convenience have gained control of any important parts of the country (see article).

No army wants its soldiers to die, but a fight on the ground will have to be risked if America is to achieve its aims of capturing or killing the al-Qaeda leaders and dislodging their Taliban protectors. Mr bin Laden has claimed that the American “superpower” is really no power at all because it will not bear casualties. After the attack on their homeland, Americans may be about to prove him wrong. He had better not be right.

Faster, clearer

What else has changed? Divide it into three: tendencies that have accelerated; dispositions that have been clarified; and things that have either plainly changed, or plainly not.

Chief among the accelerations has been the move towards economic recession in America, Asia and Western Europe. This was already likely before September 11th, as the bursting of the high-tech bubble was hitting corporate investment quickly and consumer spending more gradually, especially in America but also elsewhere. Confidence is decisive in determining the willingness of individuals and companies to spend their money, so the terrorist attacks have naturally made things sharply worse. There are compensating forces: cheaper oil, so far, as demand drops and production remains high; increased spending on security and, in future, on defence; and a greater willingness among governments to boost demand through monetary and fiscal policy (see article). But these positive forces remain weaker than the negative ones. How long the recession lasts will depend above all on confidence—which in turn will depend on the war.

The other main acceleration has been the maturing of George Bush's administration in America. All new

presidential teams take time to settle down and end their early scrapping, and this one was certainly no exception. Chances are, by the end of this year it would already have found some sort of balance between its unilateral, America-first, instincts and its need to work with other countries to achieve its aims. September 11th did not, in other words, produce a sudden change in the Bush administration's stance; it accelerated a process which would have happened anyway.

Which other countries can America now work with? The answer is surprisingly many, at least when dealing with the direct task of the war in Afghanistan. What is harder is to tell which of these surprising alliances is likely to be opportunistic and thus short-lived, and which could endure. In another article we try to untangle the webs connecting not only the traditional superpowers of America, Russia and China but also many smaller or less heavily armed countries.

The enthusiasm shown by Russia for America's cause has been particularly notable. In part, this can be explained by narrow self-interest in dealing with its own Muslim war, in Chechnya. Beyond that, however, September 11th does appear to have cast a bright, clarifying light on a broad area of overlapping interests between the old cold-war adversaries. Nothing has really changed to make Russia more co-operative in the Balkans, less antagonistic towards NATO enlargement, and more receptive to negotiation over missile defence and the anti-ballistic missile treaty (and these dispositions are still disputed by some powerful Russians). But Russia's basic interest in dealing with the West rather than confronting it, and America's in facilitating this, have become plainer to see. More tentatively, the same may be true of Iran: the room for a stand-offish sort of co-operation had long been there, but this was made clearer by September 11th.

Finally, the things that really have—or plainly have not—changed. One that has changed is covered in another article, on Northern Ireland. One that hasn't is the conflict in Israel's occupied territories (see article).

The clearest change, though, is in Pakistan's relationship with America and with it, perhaps, the prospects for negotiations with India over Kashmir. Another can be found in Japan's new willingness to bend its constitution and provide logistical support for the American military effort. It may not matter in this campaign, but it could well prove important in some future conflict. That could be quite a nuisance for China, whose relationship with the United States is one of the biggest things that plainly has not really been changed. The scratchiness over spy planes has passed, and China has caused no trouble over the American effort in Afghanistan. But the basic tension between the two over Taiwan, and hence over missile defence, remains unaffected. In a turbulent world, continuity can be comforting. But not that sort.

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Northern Ireland

I Renounce Arms

Oct 25th 2001
From The Economist print edition

This time, thanks in part to September 11th, it's almost true

Reuters

Get article background

THE peace process in Northern Ireland has been dotted by many supposedly “historic” breakthroughs, most of which have turned out to be flawed in some way, or have led to disappointment. The Good Friday Agreement of 1998 was called “historic” even though it was vague about whether and how the IRA would give up its weapons. The birth in 1999 of the Northern Ireland Assembly was called “historic” even though this body has been in suspended animation since David Trimble, its unionist first minister, resigned last July in protest at the IRA's continuing refusal to disarm. This week the IRA claimed, and General John de Chastelain's independent commission confirmed, that it had at last put a substantial quantity of arms, ammunition and explosives completely “beyond use”. This genuinely is historic: not only because the IRA had previously looked upon disarmament as a surrender but also because it allows the previous historic dots to be joined up in a way that might plot a course towards permanent peace.

In Northern Ireland, disarmament—“decommissioning”, in the jargon of the peace process—matters more for its symbolism than its practical impact. General de Chastelain has not disclosed publicly how many weapons the IRA has put beyond use, nor how many he expects it to decommission in the future. But symbols matter. By making a start, the IRA has delivered to Mr Trimble the gesture he had been demanding in order to persuade his Ulster Unionist Party that the IRA has given up the gun for good and that Sinn Fein, its political arm, is a respectable partner in the province's power-sharing executive. Mr Trimble has spoken to General de Chastelain and declared himself satisfied. If he in turn can satisfy his party's executive at a meeting he has called for October 28th, the way will be open for the assembly, and its associated cross-border north-south institutions, to resume their work.

It is natural for unionists to remain suspicious. Having refused so often before, what inspired the IRA to start decommissioning now? Plainly, part of the answer has to do with September 11th. The terrorist attacks on New York and Washington may not have changed everything, but they changed the attitude of many Americans towards the conflict in Northern Ireland. Even the IRA's traditional supporters find it hard to see why the IRA needs to hold on to its weapons while George Bush is fighting a global war against terrorism, with Tony Blair staunch at his side. The arrest in August of three republicans whom the Colombians say were helping to train left-wing guerrillas had already angered the Bush administration and embarrassed Sinn Fein.

Even so, unionists would be making a mistake if they construed the IRA's decision as nothing more than a stratagem to win back American favour. Indeed, there are grounds on this occasion to accept at, or near, face value the explanation that the IRA itself gives for its actions. In a bad-tempered letter from the fictitious P. O'Neill, it says that its aim was to “save the peace process” from those in the unionist leadership and “the British establishment” intent on using the issue of arms “as an excuse to undermine and frustrate progress.”

The bad temper is an unintended tribute to Mr Trimble, and to his establishment friends. It is often said that Sinn Fein and the IRA never submit to pressure. This time, they have. By resigning over decommissioning, Mr Trimble forced Gerry Adams, Sinn Fein's leader, to weigh what he stood to gain by keeping the new political institutions alive against what he stood to lose by allowing them to collapse. It should be no surprise that the gains outweighed the losses. By joining peaceful politics, Sinn Fein has

managed to supplant the SDLP as the main nationalist party in Northern Ireland. As for Mr Trimble's establishment friends, they let Mr Adams know in advance that in return for decommissioning he would duly receive the “swift and generous” response he demanded from Mr Blair. He has not been disappointed: by midweek, the British army had already begun to dismantle bases and watchtowers as part of the demilitarisation Sinn Fein had long demanded. September 11th may have been what finally tipped the IRA into decommissioning. But it was probably a direction in which Mr Adams already wanted it to go.

Pascal's wager

Even after this momentous week, a peaceful end is not pre-ordained. Mr Trimble may succeed in leading his Ulster Unionists back into the assembly, but more extreme or suspicious unionists will continue to quibble. The IRA has begun to decommission, but there will be arguments about how far and fast it should go. It is standing by its ceasefire, but violent splinters say that they will continue the fight. The loyalist paramilitary groups are so far refusing to put any of their own weapons beyond use until they are offered unspecified concessions of their own. And even if the violence ends, the political conflict that spawned it may prove impossible to resolve. Northern Ireland's Protestant majority sees the assembly as close to a permanent arrangement to keep the province British while buttressing the rights of the Catholic minority. For nationalists it is a staging post: a way to manage the conflict peacefully until the inevitable decision to form a united Ireland.

What if the nationalists are thwarted? The IRA is a terrorist organisation which, before its ceasefire, was in the business of killing and maiming civilians throughout Northern Ireland and mainland Britain. In 1984 it blew up the Grand Hotel in Brighton in an attempt to murder the British cabinet. It has not yet achieved its declared aim of uniting Ireland. Even after this week's decommissioning it retains most of its weapons and could in theory choose to use them again. Can anyone be certain that it has renounced the armed struggle for good?

No. But this is the time to apply to the conflict in Northern Ireland the “wager” that Blaise Pascal applied in the 17th century to God. He reasoned that you might as well believe in God because if he did not exist you would lose nothing, whereas, if he did exist, believing in him might earn you a place in heaven. In Northern Ireland at present there is, likewise, nothing to be lost and much to be gained by taking Sinn Fein at its word. The key will be to hold it to its word.

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The future of NASA

Unmanned

Oct 25th 2001
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America should stop putting humans into orbit

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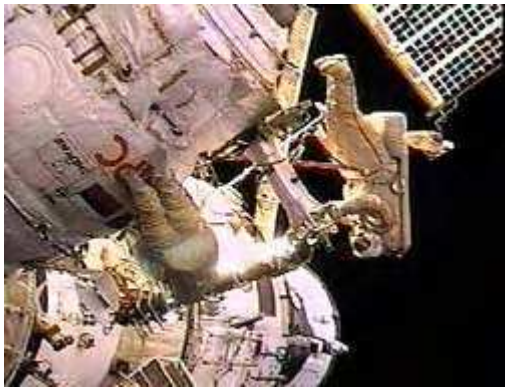
Reuters



WE'VE said it before, and we'll say it again: sending people into space is pointless. It is dangerous, costly and scientifically useless. Yet this is a lesson that NASA, America's National Aeronautics and Space Administration, has never managed to learn. As a result, it has lurched from crisis to crisis. Most of these crises have been budgetary (the combined cost of the International Space Station and the fleet of space shuttles needed to service it is almost $5½ billion a year). But even the explosion of a shuttle in the mid 1980s, which killed its crew and a civilian passenger, was not enough to close down the manned-spaceflight programme.

At the moment, this is kept alive by three things. The first is showmanship. NASA feels (correctly) that it has to keep taxpayers on its side, and also (more dubiously) that manned flights are the way to do that. Second, the space station helps diplomatic relations with Russia, the number-two partner in the enterprise, and also keeps lots of Russian rocket scientists out of the pay of countries such as Iraq and North Korea. Third, and most disgracefully, it puts billions of dollars into the pockets of aerospace companies such as Boeing. It is, in other words, a disguised industrial subsidy.

There is now a chance to change direction. In the past few days both Daniel Goldin, the agency's boss, and Joseph Rothenberg, the man in charge of the space station and the shuttle programme, have resigned (see article). New brooms can therefore sweep. And, during his time, Mr Goldin pointed the direction in which they should be sweeping. He conceived, and delivered, “faster, better, cheaper” unmanned scientific missions. In the old days, a scientific mission could cost up to $1 billion. Now, stuff gets done for a fraction of that sum. *Mars Odyssey*, which has just gone into orbit around its intended target, is regarded as expensive at $300m.

Astronomical costs?

Yet that is precisely the point. “Faster, better, cheaper” is a hard philosophy to apply to the manned side of the agency's remit. First, therefore, America should kill the space station. That would upset the Russians and the aerospace industry, but would have a negligible impact on science. And if all those Russian rocket scientists are still seen as a threat, a liberal showering of American work permits ought to disperse it. Second, a plan for phasing out the shuttle fleet should be devised. Throwaway rockets can do the job perfectly adequately.

The agency should then concentrate on what it does well—science. Pictures from space telescopes and missions to the planets are good for public relations as well as good for research. It could even learn from the Near Earth Asteroid Rendezvous craft that recently probed an asteroid called Eros. That was subcontracted (in this case to Johns Hopkins University, in Baltimore), and was one of the most successful projects in recent years: “faster, better, cheaper” clearly applies to organisations, as well as to spacecraft. Probably, NASA will take this advice only when pigs fly. Then again, it has been launching pork barrels into orbit for years.

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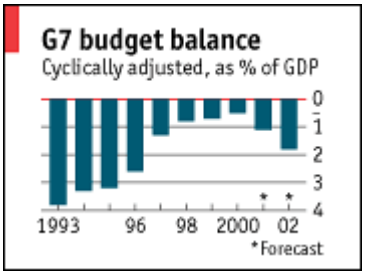
How should fiscal policy be used to support a slumping economy?



AFTER a decade of budgetary prudence, Keynes is back in fashion. America looks set for a fiscal stimulus of at least 1.5% of GDP to help revive its economy. France announced a modest stimulus last week and now five economic institutes have urged the German government to bring forward planned tax cuts to revive growth. Singapore plans a fiscal boost worth a massive 7% of GDP. However, focusing on the size of such packages ignores two important questions. What is the appropriate balance between fiscal and monetary policy? What shape should tax cuts or spending increases take?

The extent to which governments can or should pursue fiscal easing varies. The “stability pact” (which limits budget deficits to a maximum of 3% of GDP) rules out a big stimulus in most of the euro-area. Yet governments still have room to allow automatic stabilisers to operate. It is essential that they do not tighten policy to offset the automatic loss of tax revenues and the rise in jobless benefits as economies sink. In America, balanced-budget rules are already forcing states to tighten policy, partly offsetting the federal stimulus (see article).

There are, however, two reasons why the euro area should not use fiscal policy as aggressively as America has done. Monetary policy is more suited to support demand because it is easier to reverse if the economy recovers unexpectedly fast. But in America excess debt and overcapacity may have blunted the economic impact of lower interest rates. In contrast, the euro area has avoided such excesses and so monetary policy remains effective. A second difference is that America starts with a budget surplus and so can afford a stimulus. Many of the euro-area economies are already in deficit and so a fiscal easing is more likely to push up bond yields as markets fret that public borrowing is on an unsustainable path.

Where a budget surplus exists, how might a government best use it? The economic impact of a stimulus depends upon the mix of tax cuts and spending increases. Even the best designed policy cannot prevent a recession, but it can ensure the biggest boost to demand at the least cost. A first rule is that government spending gives a bigger boost to the economy than income-tax cuts, part of which will be saved. The Federal Reserve estimates that a $1 increase in government spending on goods and services boosts GDP after one year by three times as much as a $1 income-tax cut. The difficulty is finding enough sensible public projects on which to spend money quickly.

A second rule is that tax cuts aimed at low-earners are more likely to be spent than handouts to the rich, who tend to save more. Income-tax cuts are also more likely to be spent if they are permanent; temporary cuts tend to be saved. One of Japan's many mistakes in the 1990s was that tax cuts were only temporary. Here lies a dilemma: income-tax cuts need to be permanent if they are to boost spending, but permanent cuts—and larger future government borrowing—are more likely to push up bond yields, crowding out private investment.

The rule for corporate taxes is the opposite. Permanent tax cuts are unlikely to boost investment, which is influenced more by profits, excess capacity and confidence. On the other hand, a temporary tax break for investment could well work, encouraging firms to bring forward capital spending.

How do the ideas being considered by America's Congress score on these criteria? They focus too much on corporate taxes, and the incentives for business investment are permanent—exactly the opposite of what should be done. The permanent part of the income-tax cuts, bringing forward planned cuts, will mainly benefit richer Americans who are more likely to save it. The tax rebate for the low paid is only temporary.

The risk is a package shaped too much by ideology rather than economics. Lower tax rates for firms and workers are worthy long-term objectives, but today's problem of insufficient demand cannot be solved with measures designed largely to boost supply. Keynes's solution to the Great Depression was that governments should even be willing to pay people to dig holes and fill them in again. America should avoid such a deep slump, but its policy makers are in danger of digging their own economic—and perhaps political—grave.

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Dealing with anthrax

Patent problems pending

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From The Economist print edition

The rich world should apply the same rules to drugs in poor countries as at home

EPA

WHEN is it right for a government to grab a company's patent rights in the interest of public health? Scared by the anthrax outbreaks south of the border, Canada's health ministry decided that public health came first. It commissioned a generic drug company to make a million doses of ciprofloxacin, a drug used to treat one of the nastier forms of the disease, for the national stockpile. But the patent to Cipro belongs to Bayer, a German drug giant. Bayer protested that it could supply Canada's needs and that, by turning to a generic rival, the ministry had broken the law.

Canada's hasty actions had little justification. There have been no anthrax outbreaks there and no evidence of spores travelling through the post. Several other antibiotics, aside from Bayer's drug, are effective against the most common form of the disease; their patents have already expired. The government did not even take the politically sensible—if unjustified—step of declaring a national emergency, in which case “compulsory licensing” (as such patent expropriation is known) is legally permitted with compensation to the patent-holder.

Canada's Cipro saga ended this week: Bayer donated hundreds of thousands of tablets now and promised to deliver a million later in case of an emergency. But the issue will remain. American officials too threatened to follow Canada's example in order to ensure a steady supply of drugs.

Of AIDS and anthrax

There is an irony here. Other countries want to bend patent rules in the interests of public health; indeed, this is what Brazil, South Africa and other poor countries battling with AIDS have been trying to do. And yet, these countries have come under attack from the developed world, particularly America, for subverting international intellectual-property rules. But surely millions of victims of HIV in Kenya are as much of a national emergency as a dozen cases of anthrax in America?

This contrast will doubtless come up at next month's meeting in Doha of the World Trade Organisation (WTO). Deals there will probably include a ministerial declaration on the impact on public health of TRIPS, the international ground rules on intellectual-property rights that all members of the WTO are bound to observe sooner or later. Many poor countries, among them India and Brazil, are calling for change.

Some of their proposals should be resisted, as they are aimed mainly at boosting their domestic drug industries. But others should go ahead. For instance, it would be reasonable to extend the definition of compulsory licensing to allow poor countries which, unlike Canada, lack the domestic industrial capacity to produce the drugs they need, to import them from elsewhere. More important is attitude: TRIPS in its existing form is flexible enough to allow poor countries to satisfy their public-health goals, as long as other member states do not complain when they legitimately exploit flexibility in the agreement. One of those loopholes is the right to allow compulsory licensing to handle a national emergency.

Patent protection is, of course, only one reason why poor people cannot get their hands on life-saving medicines. And patents exist for good reasons. Developing new drugs is a costly and time-consuming exercise; it is only fair that pharmaceutical firms have an opportunity to recoup that investment, and an

incentive to design better medicines. But this is a good time for America and its industrialised allies to soften their hard line on patent enforcement around the world. The attacks of September 11th have shown America to be as vulnerable as other countries; it would do well to extend the same goodwill as it may one day need in return.

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Letters

Oct 25th 2001
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The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Anti-war Americans

SIR – Last I heard, protesting against war is not treason in America, though I am sure that the Republican Party and George Bush would fix that if they could (Lexington, October 6th). Indeed, the greatest thing about America is the freedom to speak out against its worst policies. Perhaps the sound of too many flapping flags has distracted you from remembering this detail.

Unlike the thoughtless and intolerant herd, I do not take the jingo-riddled path of flag waving. I show support for my country in ways that actually matter: by exercising my right to vote; expressing my opinions to my elected representatives; and pledging to fight, pen in hand, for the principles of freedom and self-determination that make America the world's greatest place to live.

Gil Bassak
Ossining, New York

SIR – Like many other apologists for the corporate-military right, you miss the point of the left's response to the events of September 11th. The peace movement in America and abroad is largely united around one belief: that the taking of innocent human life is wrong, regardless of the circumstances. The government in this country, ably supported by the media, has so far been successful in perverting this position into one that suggests support for the Taliban or Saddam Hussein, and by extension the oppressive policies of the regimes in Afghanistan and Iraq.

The left does not have the right's luxury of believing that the senseless killing of innocent civilians in Afghanistan is a fair price to pay for security in the West. In the absence of such quick-fix solutions, it is only natural that the complex dialogue around what to do next would often seem cloudy or fraught with disagreement. This is to be expected; it is neither a sign of moral weakness nor lack of resolve.

David Willis
Alexandria, Virginia

SIR – You interpret the Gulf war as an altruistic effort by America to help the local Muslims in Kuwait. Any suspicion one might have entertained that the West intervened in order to retain control of the chief oil-producing area of the world can be put to rest for good. You are evidently making a good head start on your cover story on the propaganda war.

Spyros Vretos
Athens

Religious education

SIR – It is true that critics of state-funded religious schools are using recent events to warn against the creation of more such schools and the continuation of existing faith schools ("With God on our side", September 29th). Most of these critics were opposed to such schools prior to the events of September 11th. One of the dangers of the present crisis is that all things religious, including religious schools, which were the pioneers of universal education in Britain, will be caught in an anti-religious backlash.

In London, Church of England schools provide a good education for children of all backgrounds,

nationalities and faiths, but within an overall set of Christian values. As religious schools take faith and belief seriously, rather than dismissing it as arcane or the preserve of the foolish, they are often more likely to ensure that pupils have a good understanding not only of their own religious background but of others too. As for faith schools allegedly encouraging segregation, what about post-code segregation where admission to some schools is on the basis of whether you can afford a house in the catchment area?

Every school carries with it a set of values and beliefs; no school is “faith free”. In a pluralist society there must be a recognition and acceptance of diversity and that must find practical expression in a diversity of schooling. If the critics of faith schools have their way, the only value and belief system promoted in schools will be the one emanating from that particular, but currently dominant, sect of liberal secularism.

Rt Rev Peter Broadbent
Chairman, London Board of Diocesan Schools
London

Green future

SIR – You are half right about the environment (“Economic man, cleaner planet”, September 29th). The market can be a powerful driver of environmental quality and progress, but the environmental challenge of the 21st century will be to reduce the level per unit of economic activity of resources consumed, materials used, wastes generated and pollutants released.

Unless and until the environmental intensity of economic activity is reduced at a rate faster than the rate of growth, the overall environmental burden will continue to grow. Thus, we need to do more than tinker with policy tools. We need to shift environmental policy away from its overriding concern with regulating negative outputs towards improving the efficiency and productivity of energy, materials and other inputs. This, coupled with the market-based instruments, could be the basic ingredients of a clean revolution.

Owen Cylke
National Environmental Policy Institute
Washington, DC

Blair's world view

SIR – It is ironic that in comparing Tony Blair's premiership with Lord Palmerston's, Bagehot (October 6th) displays a patrician bias against Mr Blair's “getting above his station.” It nearly praises the merits of underachievement in the presence of one's betters (ie, America). Bagehot reprises the cliché that Britain is a “medium-sized country in Europe” to expound a philosophy of post-imperial lowered expectations. Palmerston was prime minister of the same medium-sized country when it governed the largest empire in history.

In the post-war years various statesmen have sought to define Britain's post-imperial identity. Dean Acheson famously said that Britain had lost an empire but had not yet found a role in the world; Harold Macmillan contended that Britain would become the wise Greeks to America's Rome. None saw Britain as a modern world power free of the psychological burdens of history.

A nation is what it makes of itself. Britain is the world's fourth-largest economy and one of its strongest military powers. Mr Blair is the first prime minister since the second world war to enunciate a detailed philosophy of British power in the modern world. It is fitting that he does so in the context of a new kind of world war. Mr Blair's idea of Britain is one that Walter Bagehot would understand and support. Would the real Bagehot please stand up?

Jon Roderick Lewis
Chevy Chase, Maryland

SIR – Bagehot comes across as decidedly parochial in the review of Mr Blair's speech to the Labour Party conference. His crime, it seems, is daring to think about global problems such as terrorism, the plight of Africa and global warming, when his time would be more profitably spent sorting out the trains and planning public-private partnerships. If not national leaders, whom do you propose should address critical issues that transcend the borders of nation states? Shall we leave it to America? Or perhaps the United

Nations? “Blimey” indeed.

Madelaine Drohan
London

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Fighting terrorism

A puzzling kind of war

Oct 25th 2001 | FAIZABAD, ISLAMABAD AND WASHINGTON, DC
From The Economist print edition

Reuters

Will it be a short war or a long one? This is only one of the questions confusing America and its allies

Get article background

AS AMERICAN bombs and missiles rained down on Afghanistan for a third week, it seemed that two different views of the war—or, at least, two different presentations of the same facts—were emerging in Washington, London and other friendly capitals. Civilian leaders, diplomats and those most sensitive to the feelings of queasy allies are hoping that the air war will be restrained, surgical and swift, and that military efforts can soon give way to a different task: namely, building a new regime in Afghanistan, broadly supported within the country and generously assisted from outside. In contrast, military commanders, such as America's General Richard Myers, the chairman of the joint chiefs of staff, and the politicians who are closest to them have been warning that the campaign could be long, complex and messy.

Vice-President Dick Cheney deepened the gloom by saying that the heightened threat of terrorism might need to be confronted for decades. General Myers, like his British counterparts, has hinted that the campaign in Afghanistan alone might last well beyond next summer.

The British government was determined to strike a more upbeat note as it prepared at least 1,000 men to join their American comrades in possible ground operations in Afghanistan. All nine of al-Qaeda's training camps in Afghanistan had been put out of action, insisted Geoff Hoon, the defence secretary; nine airfields and 24 military barracks had also been struck successfully.

In Washington, the Defence Department put the same news more cautiously. Rear-Admiral John Stufflebeem, briefing reporters at the Pentagon, said he did not know of any training facilities which had not been struck. In any case, it was now believed that the graduates of these facilities were now fighting alongside the Taliban army as a single force. Osama bin Laden was believed to have aligned his fighters, and his fate, more closely than ever with Mullah Muhammad Omar, the Taliban's leader. “I'd be surprised if one could survive without the other,” said the admiral.

This assessment seems to have underpinned the first officially announced American ground operation in Afghanistan, which took place on October 19th. More than 100 army rangers and other special forces carried out a hit-and-run operation in and around the Taliban stronghold of Kandahar; their mission was to destroy bunkers and arms depots, and also to gather intelligence on the Taliban and al-Qaeda leadership. Many more such missions may be needed before the terrorist network is decapitated.

With only a few weeks to go before the holy month of Ramadan, by which time Pakistan's President Pervez Musharraf and other Muslim leaders would like to see the bombing stopped, and another week or two before the onset of heavy snow, the Taliban have yet to suffer any decisive reverse. American forces have somewhat intensified their bombing of Taliban positions north of Kabul, though with less force than the Northern Alliance of Tajik and Uzbek fighters would like. There is comparatively little fighting on the ground. Since September 11th, front lines in most of the country have not moved far.

Much of the “fighting” between Afghan forces seen on television in the West is in fact no more than target practice kindly staged for visiting cameras. Where territory has changed hands, military action has not always been the chief reason. The Taliban gained control of Afghanistan in the first place largely thanks to their financial clout: where they are losing ground now, the reason is often that they are being outbid, one way or another, for local commanders' loyalties (see article).

What may be the most important battle in this peculiar war is almost unseen by outsiders. A road 2,000km (1,250 miles) long snakes round Afghanistan's central mountains and is the artery that connects the Taliban-controlled regions in the north and the south. The central idea of the Northern Alliance, the anti-Taliban coalition that runs the north-east and most of the middle of the country, is to cut this road as it runs through the western province of Herat. That would detach the Taliban-controlled areas in the north, such as Mazar-i-Sharif and Taloqan, from supplies and reinforcements coming from the Taliban strongholds in the south.

AP

Less than meets the eye?

According to Mahajudin Mahdi, a senior Northern Alliance official in the capital of neighbouring Tajikistan, the alliance has gained more than 200,000 square kilometres in the centre of the country in the past two weeks, more than reversing the gains made by the Taliban in the aftermath of the assassination of the opposition's military commander, Ahmad Shah Masoud, just before September 11th. “The main objective now is to cut off Mazar-i-Sharif, by taking the town of Qal'eh-ye Now,'' he says. The opposition commander in charge of this offensive is Ismail Khan, a moderate figure well-regarded in the West, who would be a central figure in any post-Taliban settlement.

Mr Mahdi said that the Northern Alliance would not launch an offensive from its mountain strongholds towards nearby Taloqan, its capital until the town was captured by the Taliban last year. “That will be the last place that we capture,” he said, citing fears of civilian casualties and the concentration of Taliban forces and foreign fundamentalist volunteers willing, indeed eager, to fight to the death. He estimated the number of foreigners (chiefly Pakistanis and Arabs) fighting on the Taliban side at 20,000, and the total Taliban forces in the north at 60,000.

There is little sign anywhere in the opposition-controlled territories of foreign military aid. Even if it crossed the border, or was landed at the opposition's only airstrip, in Faizabad, bringing it to the front line would be a gruelling logistical task, and all but impossible when winter arrives early next month. The Anjoman pass that connects the Panjshir, and thus the approaches to Kabul, with the rest of the north-east is already thick with snow and barely passable. Neither side is equipped for high-intensity mountain warfare.

Despite that, Mr Mahdi and other military commanders say that winter will favour the anti-Taliban forces. Cold weather makes a Taliban counter-attack in the mountainous regions of the country very difficult. The places that the Taliban are defending, such as Mazar-i-Sharif in the north, and cities elsewhere such as Kandahar and Jalalabad, are flatter and warmer, meaning that winter will prove less of an obstacle to the attacking side.

Real military co-ordination between the opposition and the Americans is far from evident on the ground. There is practically no sign of American military advisers, trainers, or intelligence officials, as there was in the Yugoslav wars. If there were, it would be hard to know who or what they might co-ordinate with. Even a charismatic commander such as Masoud found difficulty in marshalling his chieftains behind a coherent strategy. Under the current, much less impressive, leadership, central command is even more fragmented. The costs of this weakness are plain in the fighting around Mazar-i-Sharif, where quarrels between Abdul Rashid Dostum and other warlords have blunted the opposition's offensive and allowed the Taliban to regroup and counter-attack.

Impatience with American tactics is mounting on the Northern Alliance side. Few Afghans in the north show much confidence in the efficacy of the bombing strikes. Increasingly they see America as pursuing its own interests, careless of the Afghan civilian population's well-being, and with little chance of success. Attacks on concentrations of Taliban fighters have been too timid, in the Northern Alliance's view; attacks on the cities, they say, may actually be counter-productive.

Partly because of the air raids, carefully directed as they may be, life in Kabul, the capital, and Kandahar, the Taliban stronghold, is becoming miserable and chaotic. Sebghatullah Saiq, the security chief in the provisional northern capital, Faizabad, wants an immediate stop to bombing in the towns. “It will unite people against America,” he argues. His colleague, Abdul Mussadiq, the military commander in the nearby town of Argun, says the same: “Americans believe they are targeting the Taliban and their so-called guests, but the television pictures show that the main victims are civilians.”

The dilemma this poses for the United States is obvious. Pentagon officials are anyway growing concerned that their enemy is becoming more elusive. Rear-Admiral Stufflebeem said there were plausible reports that the Taliban were melting into the civilian community, holing up in the centre of towns or even in mosques, so as to make it more difficult to attack them without causing civilian casualties.

Even now, tragic and politically embarrassing accidents are happening, the Pentagon acknowledged, as it reacted defensively to an allegation by the United Nations that a hospital had been hit in the western city of Herat. What the Pentagon admitted was that a stray bomb had landed outside an old people's home, perhaps close enough to cause casualties.

Diplomatic muddle

Meanwhile there have been signs of progress, but no real breakthrough, in diplomatic efforts to construct a post-war regime—what has become known as a “broadly-based government” or BBG. In London, the foreign secretary, Jack Straw, made a bid to put Britain at the centre of this attempt when, in a speech on October 22nd, he set out a series of principles to govern the country's reconstruction. Afghanistan's future should be determined by its own people, but a “global coalition” would be needed to rebuild the country. The United Nations would set the process in motion, with the wealthy nations of the world digging deep to provide the resources. Having delivered this message, Mr Straw flew to Washington to

confer with the State Department about how to put his lofty ideals into practice.

Almost simultaneously, a moderate veteran of the anti-Soviet struggle in the 1980s, Pir Sayed Ahmad Gailani, was convening a meeting of mainly Pushtun notables in the frontier city of Peshawar in the hope that the anti-Taliban (or at least potentially anti-Taliban) Pushtuns could be stitched together into a more effective political and military force. Because the Taliban themselves are Pushtun—an ethnic group that accounts for nearly half the country's population, and for millions of people in adjacent areas of Pakistan—there can be little hope of drawing support away from the current regime unless something like Mr Gailani's effort bears fruit. He is close to Muhammad Zahir Shah, the 87-year-old former king who has been cultivated by the Americans.

Interviewed in Islamabad this week, Hedayat Amin-Arsala, a former foreign minister who is now a special envoy for the ex-king, said he had been in “indirect contact” with elements of the Taliban who might switch sides if a serious alternative, under the leadership of the former monarch, were in sight. The 120-strong council, mooted as an organ of transitional authority, could be expanded to make it more representative, he suggested.

While insisting that anti-Taliban Pushtuns were doing what they could to organise a resistance, Mr Amin-Arsala expressed frustration that American help had yet to materialise. But he still believed that the Taliban rule could collapse “like a house of cards” once a clear alternative was in place, and that this collapse might only be a few weeks away.

This implosion, and the Taliban's replacement by a government still with Pushtun representation but more amenable to the West, can hardly come too soon for the hard-pressed government of Pakistan. There were signs this week that Pakistan and Afghanistan might yet become a single war zone. An American helicopter came under fire in Pakistan while on a mission to recover another, damaged, chopper, the Pentagon disclosed on October 23rd. And at least eight members of a Pakistan-based group of Islamic militants were killed in an American raid on Kabul.

Amid the difficulties, the crucial tactical question is this: how far does America want its allies in Afghanistan to march, and how soon? Colin Powell, the secretary of state, confirmed on October 21st that America was keen to see Mazar-i-Sharif change hands, whereas the desirability of an assault on Kabul, the capital, by Northern Alliance forces, was still an open question. Mr Powell noted that the alliance wanted at least to “invest”—an old-fashioned word for a mild sort of siege—the Afghan capital. “Whether they actually go into Kabul, or whether that's the best thing to do or not, remains to be seen,” he added.

Decoded, this suggests that America is striving for an understanding with the Northern Alliance: we will help you, or at least attack your immediate enemies, but in return you must hold back from marching straight into Kabul. Mr Powell spelt out more bluntly than before the shortcomings of the alliance as a basis for a national government; he said it represented only about 15 % of the country's population.

In certain quarters the alliance still has friends. Vladimir Putin reaffirmed support for the northerners by flying to Tajikistan to meet its leaders and treating them as though they were already the masters of Afghanistan. This show of friendship was angrily observed in Pakistan, whose intelligence service remains extremely suspicious of the old Russian enemy. The possibility that the Taliban's defeat will lead to another round of tribal blood-letting, and geopolitical competition, looks real.

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Taliban defectors

Tempting offers

Oct 25th 2001 | FARKHAR
From The Economist print edition

Some of the Taliban are asking where their loyalties lie

FROM the way the messenger clicked his worry beads, you could tell he was nervous. He had come to a meeting several hours' drive from this inaccessible town, bearing scraps of paper from three Taliban commanders. They were offering to defect to the opposition Northern Alliance along with their men. The local Northern Alliance commander asked that all names and the location of the meeting be kept secret. The deal had not been clinched and the Taliban do not know that these commanders are trying to jump ship.

All along the north-eastern front line, opposition commanders say that messengers are criss-crossing the lines. This one says his three commanders would bring 400 soldiers with them. If similar numbers are being discussed elsewhere, it may explain why the Northern Alliance has not yet begun a major push. It is waiting to see how many from the other side are willing to defect first.

Circumstances may be less favourable to defection elsewhere. This messenger came from ethnic Tajik commanders; the Northern Alliance forces ranged against them here are also mostly Tajik. They say they can no longer live with the Taliban regime, which is dominated by Pushtuns, Afghanistan's largest single ethnic group.

Messengers are not the only men crossing the front lines. Boys of military age from nearby Taliban-held Taloqan have been arriving here in droves—ever since an armed Taliban press-gang stormed into the Abu Osman High School in Taloqan two weeks ago, herding out 20 boys at gunpoint.

When night falls the Northern Alliance attacks the Taliban with fearsome rockets from truck-mounted Soviet-era rocket-launchers. Afterwards, the silence over the pitch-black front lines is broken only by the menacing thud of invisible American helicopters. Hardly surprising that some Taliban commanders are thinking about their loyalties.

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The diplomatic repercussions

Seeing the world anew

Oct 25th 2001
From The Economist print edition

AP

September 11th changed the way America, its friends and its rivals think about foreign policy

“NIGHT fell on a different world.” That was how George Bush put it, and he was right. Whether the events of September 11th are seen merely as an attack on the world's most powerful country or, as many have argued, an attack on civilisation itself, no government—front-line state or bystander, friend or foe—has been immune from the repercussions.

The military, diplomatic, financial and intelligence campaign America is leading against Osama bin Laden and the Taliban—“the first war of the 21st century”, as Mr Bush describes it—is barely under way. Yet, reverberating out from Afghanistan through Central Asia and the Middle East to Europe and Asia, unexpected diplomatic shifts and accelerated changes are already happening. Something of the shape of the new world Mr Bush talked of can already be discerned through the fog of the “global war on terrorism”.

Britain's Tony Blair is determined that “out of the shadow of this evil, should emerge lasting good.” Pakistan's Pervez Musharraf, whose own regime has helped to sustain the Taliban, has sided with America against them. Russia's Vladimir Putin has seized the moment to try to transform relations with America. Elsewhere, the spotlight on terrorism has seemed to change the terms of just about every conflict, from Northern Ireland to Macedonia and Kashmir. Even countries long hostile to America have been quietly recalculating the costs and benefits of trying for a new diplomatic breakthrough.

Even countries long hostile to America have been quietly recalculating the costs and benefits of trying for a new diplomatic breakthrough

Mr Bush himself has talked more prosaically of the “interesting opportunities” the anti-terrorism campaign affords: to end the chronic instability that Afghanistan has brought to all of Central Asia; to warm frost-bitten relations between India and Pakistan; to stop the cycle of violence between Israel and the Palestinians; to “shake terrorism loose from state sponsors” (by which America means Iran, Iraq, Libya, Syria, Sudan, North Korea and Cuba). As this month's dangerous flare-ups in disputed Kashmir and between Israel and the Palestinians show, some problems will be harder to work on than others. But progress in any of them could bring widespread knock-on benefits.

How much progress will influence how successfully America can damage the terrorist international around Osama bin Laden. So will the help America gets from others. As Mr Bush's weekend talks in Shanghai with Mr Putin and China's Jiang Zemin showed, there are now broader opportunities: to refashion relations with Russia; to strike up a more constructive dialogue with prickly China; and as a result to

rebalance responsibilities around the world with allies in Europe and Asia.

Whether a new order is being forged, or simply a remake of the old one, success will depend just as much on America itself. Does Mr Bush have the vision, and America the staying power, to seize the opportunities that present themselves?

Define your moment

Doubters claim that, before September 11th, Mr Bush had a narrow domestic agenda and a divisive view of America's role in the world. Allies took offence when he refused to ratify international agreements the previous administration had signed—on an international criminal court, a nuclear-test ban and the emission of greenhouse gases. In many ways, this was a caricature. (The previous administration may have signed the Kyoto accord, for example, but did so knowing that it would be impossible to uphold.) Still, Mr Bush and his team debated whether America should try to bring others along or simply go it alone. And they let all else in foreign policy seem bent towards a single end: the president's unswerving determination to build new missile defences.

What came across to the outside world was an unnerving unilateralism. Now that America has a second focus—the fight against terrorism—this will have to change. Otherwise, some of those “interesting opportunities” Mr Bush has talked of will close off fast.

He sounds just as determined in the second cause as the first. “We have found our mission and our moment,” he says. To other governments he has been equally uncompromising: “Either you are with us, or you are with the terrorists.” But this mission is different. Going after the bin Laden group and those who harbour them, mounting a concerted global assault on terrorism in general, as Mr Bush has promised, will not be accomplished either easily or quickly. Or by America alone, since the al-Qaeda network is said to operate in more than 60 countries.

On the contrary, this campaign, rather like the cold-war mission to contain communism—likewise a military, political and ideological struggle—will need to be broad and sustained. It has already set new budget priorities at home, and has begun to reshape the deployment of American military and diplomatic power abroad. It has reanimated a debate on military reforms and will accelerate the priority given to more mobile, differently equipped forces. It will reinforce the shift in America's military footing from Europe, which is stable, towards Asia, which is less so. More broadly, says the secretary of state, Colin Powell, it sets a “new benchmark” for American diplomacy, a new measure of friend and foe.

There is nervousness among some front-line states in Central Asia and even among America's close allies that the hyper-engagement of recent weeks will turn out to be no more than a means to pursue short-term military ends. During the Gulf war many governments, including Arab ones, joined the American-led coalition against Saddam Hussein's Iraq, only to find themselves dealing with the same dangerous regime when the war was over. The worry now is that, having pulled much of the world together to defeat al-Qaeda, Mr Bush will decide at a point convenient only to America to declare victory and leave others to pick up the pieces.

Such fears fail to see that America has changed irrevocably because of September 11th. Americans no longer feel safe at home. Turning their backs on the world no longer works. Nor will simply knocking hell out of the Taliban. Even such a confirmed do-it-yourselfer as Donald Rumsfeld, the defence secretary, admits that retaliation alone cannot solve this problem.

Americans no longer feel safe at home. Turning their backs on the world no longer works.

But there are other worries. One is that, under the cold-war logic of “my enemy's enemy is my friend”, America will miss the real world-reshaping opportunities, doling out favours and arms to unsavoury regimes, falling silent over Russia's tactics in Chechnya, or overlooking China's poor record on human rights. American officials deny this, and Mr Bush pointedly reminded Mr Putin in Shanghai that a war on terrorism should not be used as cover for a clampdown on minorities.

Countervailing forces

Might America's military strategy and its diplomatic strategy find themselves at war with each other? Mr

Bush was being lobbied even before September 11th by an influential group among his advisers to try to topple the Iraqi regime. A bash-Iraq group is now pressing to extend the war to take care of this “unfinished business”, and possibly beyond. Since the biological attacks on America, Iraq has fallen under suspicion as a likely source (there are other possibilities) of the anthrax spores used, though Iraq denies it.

Broadening the war would transform the campaign against terrorism, but not make it easier to win. So far Mr bin Laden has failed in his declared aim of forcing a confrontation between the Islamic world and the West. However, if military strikes were widened to other targets, such as Iraq, without clear evidence of a direct link to the recent terrorist attacks, even the non-Muslim parts of the coalition supporting America would fracture badly.

Short of a new front opening in the war on terrorism, Afghanistan itself is already proving a first, difficult test of whether there is more to the anti-terror coalition than words of sympathy. Al-Qaeda may have reserved its worst atrocities for America, but all the neighbours—Russia, Uzbekistan, Tajikistan, China, Iran and even farther away India—have accused Islamic extremists trained in Afghanistan's camps of causing trouble for them too.

Russia, Iran and Pakistan have long supported competing factions among the warring Afghan tribes. With the Taliban discredited and under American attack, all now profess themselves keen to see a “broadly-based government” (meaning no victory for their opponents). All are wary, not only of each other, but also of America's motives. They would like American aid, but not an increase in American influence at their own expense.

The very complexity of the Afghanistan mess is forcing a rethink all round. Not even Pakistan, chief supporter of the Taliban, has an interest in seeing the country slip back into civil war. There is talk from European officials of a mini-Marshall Plan for Afghanistan once the war is over. Even Mr Bush's officials, who derided the hands-on “nation-building” favoured by the Clinton administration, are anxious to find a stable replacement for the Taliban. Since none of the locals trusts each other, and America has no desire to get stuck in Afghanistan as Russia did, thoughts are turning to the United Nations.

Bringing stability and development to Afghanistan is just the sort of job the UN might have been designed for. But bad experience in Somalia and Bosnia, and better ones in East Timor and Kosovo, have taught a still-hesitant UN that the job it can do is only as good as the co-operation and support it gets from others, especially the bigger powers.

AP

Sharon sees nothing new

America will not submit its military plans for UN approval but, heartened by swift and unanimous condemnation in the Security Council of the September attacks and UN help in tracking down terrorist finances, the Bush administration seems inclined to work with it on at least the civilian job to be done. With support rather than criticism for America's approach from a newly friendly Russia, acquiescence from China, cash from Europe and Japan, and security within the country guaranteed by others—possibly a mainly Muslim peacekeeping force led by Turkey—there could at least be a chance to break Afghanistan's cycle of strife.

For now, all this is on hold. That it can be contemplated at all is due to the biggest gain for the anti-terrorism campaign so far: Pakistan's decision to end its support for the Taliban regime.

Dangerous relations

General Musharraf admits that Pakistan had “no choice” but to back retaliatory strikes. In doing so he took a calculated risk that he could face down the inevitable street protests by Islamic militant groups and win a resumption of the aid and assistance Pakistan lost, first for secretly building nuclear weapons, then for testing them in response to India in 1998, and then for ousting the civilian government in his own coup.

So far, the gamble has paid off. Once virtually a pariah state, Pakistan is back in the mainstream, and aid of various sorts is flowing. But the changes will need to go further. For years, Pakistan has used Islam to encourage the creation of friendly governments in neighbouring Afghanistan, but also used extremist

groups on its own soil to further its much more important foreign-policy objective: to challenge Indian rule over disputed Kashmir. Indeed Afghanistan has been a useful training ground for some of these groups. Pakistan has always denied involvement in the violence in Kashmir. India claims not only to have killed Pakistani militants on its side of the line of control, but also Afghans, Sudanese, Saudis and others.

To India's fury, since its government was one of the first to back Mr Bush, America aims merely to keep a lid on such simmering regional bile. When he visited the region earlier this month, Mr Powell insisted that America's focus for now would remain on Afghanistan and al-Qaeda. But eventually, given the nuclear-tipped rivalry between the two countries, Pakistan is bound to come under strong pressure to end the incursions. Given the influence of Islamists in Pakistan's intelligence services and the armed forces, that will be tricky.

EPA

Jiang and Putin: so much in common

Early hopes that the fight against terrorism emanating from Afghanistan might help reinforce a ceasefire between Israel and the Palestinians, and even finesse a new peace deal, were likewise premature. Yasser Arafat was quick to condemn the attacks on New York and Washington. But the cycle of violence in the Middle East, like that in Kashmir, has a dynamic all its own. This week, America was scrambling to prevent worsening fighting between Israelis and Palestinians from damaging the support it has been able to win from Arab governments for its strikes against Afghanistan. The Israeli government, meanwhile, has been trying just as hard to persuade American public opinion that it too has the right to hit back at terrorists.

The Middle East conflict is one of the issues on which the terrorism of al-Qaeda and other groups feeds. Before the attacks on New York and Washington, the Bush administration was preparing to answer criticism that it was doing too little to halt the recent Israeli-Palestinian violence by ratcheting up its engagement. If there were to be a second front in the diplomatic war on terrorism, this is it. But the prospects for success seem far from bright.

Not taking offence

They could, however, be worse. One consolation is that in the new war against terrorism, unlike during the cold war, the dangers of big-power confrontation are greatly reduced. Indeed it is in the relationships between America and Russia, and between America, Russia and China, that change is happening fastest. The knock-on effects are already being felt.

Impatient with the constraints of the Anti-Ballistic Missile (ABM) treaty on his plans for new missile defences, at their meeting in Slovenia in June Mr Bush had offered Russia's president the prospect of a new strategic bargain: “move beyond” the ABM treaty and make deep cuts in American and Russian nuclear stockpiles. Mr Putin was tempted, but not convinced.

Russia had been slow to acknowledge that the threats to its security come more these days from long-range missiles in the hands of unpredictable regimes rather than from America. Unlike China, however, it has never opposed such defences outright. Its aim, rather, has been to bind America into talks that preserved Russia's last remaining claim to superpowerdom: strategic parity with America. Increasingly, the stand-off over missile defences was getting in the way of Mr Putin's other aims: to end Russia's marginalisation in world affairs, to be accorded a bigger say in European security, and to give priority to economic development and trade.

The common fight against terrorism has given Mr Putin a chance to break the log-jam. He moved quickly to offer America diplomatic and intelligence help against al-Qaeda, as well as use of Russian airspace. But he has also signalled an interest in broader changes, by announcing the thinning out of Russian troops in the Balkans and by toning down Russia's opposition to the enlargement of NATO.

How far might all this go? When they meet in Texas next month, Mr Bush and Mr Putin may be unable to strike a final deal on nuclear weapons and missile defences—and America may go ahead anyway with the expected announcement that it intends to withdraw from the ABM treaty. But Russia has already indicated that it could put up with this, and that the two can keep talking.

Similarly, giving up its futile attempt to claim a veto over NATO's future shape does not mean that Russia would be happy to see the Baltic states, once part of the Soviet Union, join the western alliance. If they do, expect Russia at a minimum to keep up criticism of their treatment of their own Russian minorities. Yet by cutting up less rough about who gets in and who does not at next year's NATO summit in Prague, Russia may actually help undermine the lobby in Congress that until now has argued for taking in as many newcomers as Russia opposes.

NATO too has a chance to think more clearly about its own future. Some have argued that by invoking Article 5 of its founding treaty for the first time, thereby declaring last month's terrorist attacks on America to be an attack on all, the alliance merely underscored its irrelevance. Though America has the right to ask its allies for assistance, critics note, it has actually asked for very little. It has preferred instead to rely on bilateral help from Britain, and on smaller contributions from others.

But the nature of last month's attacks took America by surprise too. At American prodding, “new security threats” are already officially part of NATO's military mission. Diplomats on both sides of the Atlantic are starting to think what that might mean: since the threats can come from anywhere, might a reorganised NATO, one better suited to the deployment of special forces rather than tank brigades, be prepared to go anywhere?

Such thinking might not please Mr Putin, who prefers to see NATO as increasingly a political rather than a military alliance. There are plenty of other tricky issues still on the Russia-America agenda too, from the war in Chechnya to Russia's patchy record in preventing the proliferation of missile, nuclear and other dangerous technologies. And Russia still chooses its friends, from Iran and Iraq to Myanmar, in unhelpful places. Still, the presumption of co-operation on key issues, rather than confrontation, would itself be progress.

A Chinese headache

Reordering the Russia-America agenda under the heading of anti-terrorism at least enables Mr Putin to present such changes as being to the benefit of both sides. Ironically, however, for now the biggest repercussions of Mr Putin's shifting thinking are being felt not so much in Europe as in Asia.

Over the past two years China has worked hard to build a common front with Russia against America on missile defences. Earlier this year, on China's initiative, the two countries signed a new friendship treaty, the first since the 1950s. Mr Putin's readiness to consider a new strategic bargain with America now puts China on the spot. It may respond by extending the modernisation of its nuclear arsenal, already under way. Or it may try to complicate America's plans by developing, and helping others to develop, counter-measures to defeat any new defences. But China can ill afford to seem isolated on such an important issue. Russia's decision to negotiate may prompt China to do the same.

The anti-terrorism campaign affects China's relations with America less directly than Russia's, since the main issues in dispute between the two—the future of Taiwan and China's territorial ambitions in the South China Sea—are unconnected and less susceptible to compromise. At their first meeting, in Shanghai, Mr Bush and China's Mr Jiang seemed largely to talk past each other. Yet two important, if little-noticed, precedents have been set.

The first is China's acquiescence in America's air strikes on Afghanistan. Hitherto China has flatly opposed such “interference” in the affairs of others, fearing perhaps that someday it will face an America intervening to protect Taiwan. The second is China's reluctant acceptance of new legislation going though the Diet in Tokyo that will allow Japan to offer logistical help (though not direct military support) to America in a conflict that is far from Japan's own shores. China has long sought to oppose the strengthening of Japan's security alliance with America, which it sees as its chief rival for influence in Asia.

Japan is not about to volunteer to fight at America's side. But at least the taboo against doing more security jobs with America has been partly broken. The increasing range of Japan's naval supply ships is a good measure of how far the war on terrorism can change things.

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The home front

Avoiding a Dark Winter

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The anthrax outbreak, though spreading, could have been much worse. America is trying to learn lessons from it that might be applied to future threats

AP

LAST June, a group of respected defence think-tanks met at Andrews air force base near Washington, DC, to run a computer-simulation exercise called Dark Winter. In it, they asked current and former government officials to act as if they were an American government struggling with a bio-terrorist attack using smallpox. The results were disturbing.

In the imaginary attack, three shopping centres in Oklahoma, Georgia and Pennsylvania were infected with smallpox. The first cases appeared nine days later. The “government” could not isolate victims because smallpox has an incubation period of up to 14 days, during which carriers are infectious. It did not have enough vaccine to fence off the affected areas.

By the end of the second week, there were 2,000 cases in 15 states. The officials closed America's borders and exhausted its stocks of vaccine, to no avail. By the end of the third week, the situation had become catastrophic. The medical system had collapsed. Stocks of vaccine could not be replenished in time. The number of confirmed cases hit 16,000 and the computer predicted 300,000 victims within three weeks. The government was discussing the imposition of martial law.

Back in a world that would also have seemed unreal two months ago, two more people died of anthrax on October 22nd, both postal workers at the sorting office that had handled a poisoned letter sent to Tom Daschle, the leader of the Senate. Two other postmen at the office have developed the disease. So has a third postal worker in Trenton, New Jersey. This brought the number of deaths from anthrax by October 24th to three, the total of infections to 12 and the total number of exposures to 32. The infection of postmen suggests that the strain is more potent than originally thought. On October 25th, the *Washington Post* reported that the spores found in Mr Daschle's office had been treated with a chemical additive to allow them to stay suspended longer in the air. Only three countries, Russia, Iraq and the United States, were known to have developed such an additive.

On October 23rd, a mail-opening machine in Washington that screens the White House's mail was also found to contain anthrax spores. It is unclear whether they had spilled from a letter to the president, or had been picked up at the same sorting office where the postmen died. The White House itself is free of the spores and no one there is infected.

For the victims and their families, the tragedy is unmitigated. But for the nation as a whole there is good news amid the misfortunes. In the imaginary smallpox outbreak, a local biological attack ballooned into a national crisis. The real anthrax attack has not been like that. Outside a few professions—postmen, journalists, Washington politicians—there is no immediate threat to public health. Caught early, the bacillus responds to antibiotics. And the perpetrators have so far failed to find a technology that can spray a disease over a city, causing mass casualties. They mailed death one envelope at a time.

There is, however, bad news as well. Anthrax is only one of the diseases that might be delivered to America—and not the most virulent. Ken Alibek, the former deputy head of the Soviet Union's germ-warfare programme (who defected to America in 1992), says that if a terrorist could pick one biological weapon for use against America, it would probably be smallpox or the plague. The other piece of bad news is more mundane: in response to the “modest” anthrax attacks, the American government has been found wanting in significant ways. Given that, and the other alarming threats that may exist, it makes sense to consider the lessons of the Dark Winter experiment, and ask how many of them America has learned during the anthrax attack.

The main lessons were spelled out by the Centre for Civilian Biodefence Studies at Johns Hopkins University, one of the think-tanks involved:

•**The biggest problem was lack of basic understanding**. As one participant in the exercise put it, “There is something out there that can cause havoc in my state that I know nothing about, and for that matter the federal [government] doesn't know a whole lot either.” Although much about the anthrax attacks remains unknown, in one respect things have changed dramatically for the better.

In response to the anthrax attacks, President Bush has set up an office to deal with terror at home. The secretary of health and human services, Tommy Thompson, has drafted in two of the country's best specialists, Scott Lillibridge, the former head of bio-terrorism at the Centres for Disease Control, and Donald Henderson, the former dean of the School of Public Health at Johns Hopkins. Public health has become a national-security issue.

•**Early responses are often patchy**. In the Dark Winter exercise, no one was able to identify the source of the original attack. In Florida, the Department of Health laboratory diagnosed the first anthrax case quickly. Technicians there had just completed a course in identifying bio-warfare diseases. Thanks to sudden familiarity, top laboratories are getting better at identifying rare ones.

But the picture is mixed. The backbone of disease detection in America is formed by 158,000 laboratories serving hospitals, private doctors and health-maintenance organisations. It is not clear how much they have improved. Some of the most important early-response units are those of the Civil Support Teams of the National Guard. They are a shambles. In New York, they arrived at the World Trade Centre 12 hours late and proceeded to perform environmental tests that had already been carried out. Amy Smithson, of the Henry Stimson Centre, argues that the Civil Support Teams should be closed and the money saved used to set up proper decontamination units at 50,000 hospitals.

The third early-response problem is shortage of people. Mr Thompson claims that his department has 7,000 trained medical people ready to go. Even if true, that might not be enough. In an exercise last year to test the preparedness of top officials for bio-terrorist attacks in three cities, health-care officials in Denver decided they needed an extra 2,000 doctors and nurses within a day to prevent people fleeing. Few of those interviewed afterwards thought it would be possible to get 2,000 qualified people to one place so quickly. And New York would need many times that number of extra hands.

•**America's health system cannot deal with a surge of mass casualties**. This is probably the most serious problem identified by the Dark Winter exercise. Almost a third of the country's 5,000 hospitals are losing money; 1,000 have closed in the past ten years. As Dr Henderson argues, “in their quest to eliminate inefficiencies, they have basically wiped out their surge capacity.” To save money, hospitals have also cut expensive emergency rooms. In the whole Baltimore-Washington area, there are fewer than 100 beds for highly contagious patients.

The problem goes back to the structure of American health care. Private hospitals compete, and there is no regional-planning system capable of shifting patients from one place to another. Ms Smithson says that “in most of the cities that I surveyed, the central game-plan for hospitals in the event of a major catastrophe was to...shut their doors to incoming patients.”

If possible, the public-health system is in even worse shape. Understaffed and underfunded, the system,

if you can call it that, is a collection of independent fiefs, fragmented at federal, state and local levels. They do not talk to one another, and private physicians do not talk to them. Doctors are supposed to tell public-health officials about cases of virulent diseases. But during the outbreak of West Nile encephalitis in New York in 1999 it turned out that there were 20 unreported cases of the disease already in the city.

•**There are not enough vaccines or medicines**. This was a vital failure in the Dark Winter exercise. Only one firm is under contract to produce anthrax vaccine. The plague vaccine has been discontinued by its makers. But there is some improvement with smallpox. America plans to buy 300m doses within a couple of years; the first batch is due next summer. Also, the National Institutes of Health is working on a plan to dilute doses to make them go five-times further. If this works (the results are due at the end of the year), there may be enough to immunise the country soon, assuming that this is desirable.

•**Conflicts between different levels of government hampered their response and increased the panic**. So far, there has been nothing remotely comparable to the disputes and hysteria envisaged in the Dark Winter project, which imagined food riots and National Guardsmen firing on citizens. Although cabinet members have not always known what was going on, and there have been squabbles about whether the federal government should take over airport security, these have been trivial. More important (see Lexington), there has been no public panic.

The panic could still break out. But, in this respect at least, the difference between the Dark Winter exercise and the real anthrax outbreak is somewhat reassuring. In the exercise, the government and emergency services were overwhelmed because they did not know what to do. The anthrax attacks suggest that, in some areas, the response has been reasonably good. And where it looks weak—notably in the public-health system—people at least know now what they will have to do.

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The postal service

One woe upon another

Oct 25th 2001
From The Economist print edition

Not happy before September 11th, much worse now

AP

The most dangerous job in America

FEW Americans want to be postal workers at the moment. Fewer would like to be John Potter, the postmaster-general. His list of people to soothe is vast, starting with his 800,000 nervous employees, who must feel confident that they will not get anthrax by doing their jobs. On October 24th, however, Mr Potter had to tell the country that he could not guarantee that any piece of mail was safe, and that people opening their own letters should wash their hands afterwards.

The postal service's woes began long before September 11th. Semi-independent from the federal government since 1970, it is supposed to break even over time. Instead, it has burrowed deeper into debt. In the budget year that ended on September 30th, losses caused by falling demand and rising costs were estimated (pre-terrorism) at $1.65 billion. This year's losses are expected to be $1.35 billion, pre-terrorism. Mr Potter has said that 75,000 jobs will go by 2006, there will be a freeze on capital spending, and charges are to go up by 8.7% next autumn. Even so, total debt, now around $11 billion, may soon reach the congressionally-fixed ceiling of $15 billion.

It has all got sharply worse since September 11th. The attacks are estimated to have cost the postal system $63m in damages. The Federal Aviation Administration's prolonged suspension of flights, and its new rule that parcels must not be carried on passenger flights (they have to go by cargo aircraft, or on the ground), mean a big loss of revenue.

Now add the anthrax alarm. Closing the Brentwood mail-processing office in Washington, and giving workers medical tests, will cost a lot. Other post offices round the country may close as fears spread; at the least, workers may stay at home. Some postmen, angry that their tainted offices stayed open while Congress was closed, are talking of lawsuits.

There is also talk of buying new equipment to protect against anthrax and other hazards. Latex gloves and face-masks have been offered to workers. Costlier ideas include letter-processing machines that could zap bacteria with radiation.

Business may well not pick up again, says Rick Merritt of PostalWatch. Over the past few years, the volume of first-class mail—the system's main money maker—has dropped sharply as Americans have become cosier with e-mails. Now people are even less keen to get mail at the door, especially parcels. It looks like being a postally bleak Christmas. The postal service is not alone in all this, of course; courier services, too, have suffered (United Parcel Services has reported a 19% year-on-year drop in third-quarter profits). But the traditional postman is hurt most.

Help is on the way. This week President George Bush pledged $175m to the postal service as crisis aid. Mr Potter will doubtless ask for much more, and Congress is likely to be sympathetic. But the money, say the service's critics, will merely prop up a crippled agency.

There are plenty of ways of making things more efficient. Clearer accounting would be a start; Mr Merritt suggests a top-to-bottom audit of the service. A reduction in the number of things it tries to do would also help; many grumble that the postal service has blundered into private-sector activities, such as e-commerce,where it is not very competent (and can also abuse its monopoly power). Another possibility is

faster processing of price increases; at the moment, there is usually a ten-month lag between proposal and action.

A draft bill going around Congress last month would address the last point, but little else. Talk of privatisation is so far faint. But the terrorists have made sure that the rumbles for reform will grow louder.

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The peace movement

All we are saying...

Oct 25th 2001 | SAN FRANCISCO
From The Economist print edition

A babble of unclear voices

LOOKING at the home-made signs joggling along San Francisco's Market Street on October 20th, it was almost too easy to mock. “Alternative Fuel Cars for Peace and Security”; “We're Queer; We're Here; We're not Invading the World!”; “Who Farted? This War Stinks!” The march, led by an amateur mime-and-drum performance, did little to dispel stereotypes of the Bay Area as the home of the nuttiest political tradition in America.

There has never been a war involving America, from the War of Independence onwards, that has not been vociferously opposed (sometimes by a majority) for reasons of isolationism, unwillingness to fight in that particular cause, or principled pacifism. The present war, in which young people are not being conscripted to fight and where the danger is abundantly clear and present, is no exception. Some 5,000 people turned out to join the march in San Francisco called by the Town Hall Committee (THC) to Stop War and Hate.

The THC is a loose coalition of leftish groups which, despite its name, has nothing to do with the city's government. It embraces Buddhists, vegans, pro-Palestinian activists and other radicals of all stripes. The themes for the march had been limited to the minimum everyone could agree on: stop the war, end “racist scapegoating”, stop government trampling on civil liberties. Prominent at the head of the march was a contingent of Afghan-American women opposed to the American-led bombing campaign. Prominent beside them, however, was a man with a banner that read “Support our Military”.

Across the bay in Berkeley, on the campus of the University of California, where in the 1960s and 1970s students battled the authorities over Vietnam and the draft, the Stop the War Coalition has kept the tradition of dissent alive with rallies and teach-ins. The city of Berkeley, where some veterans of those campus battles stayed on to live and work (or to smoke dope in hippie encampments on the pavement), has also done its bit. Barbara Lee, who represents Berkeley and neighbouring Oakland in Congress, cast the sole vote against the House resolution to give President George Bush war powers. The city council, after endorsing her vote, passed a resolution on October 16th calling for a swift end to the bombing. For a while, Berkeley's fire chief would not let the American flag be displayed on his fire engines, in case protesters tried to rip it off.

Yet Berkeley's defiance suggests that the peace movement is stronger and more coherent than it really is. Numbers have dropped at each campus Stop-the-War event, to a mere 300 on October 10th. At the same time a counter-presence of students supporting military action, the United Students of America, has grown larger. The city, too, is divided. The council vote on October 17th was close—five to four—and the resolution passed was milder than the one originally proposed, which called for an end to bombing immediately, rather than “as soon as possible”.

The peace movement has few good arguments to back up its three-slogan agenda. Suspicion of America's ideas and its government is deeply ingrained, and so the third slogan, defence of civil liberties in the teeth of oppression, comes naturally, whether or not it has any basis. The second point of the agenda, that America should avoid casting Muslims in general as the enemy, is one that Mr Bush has made repeatedly ever since September 11th.

As for their first slogan, that America should cease military action in Afghanistan, the campaigners are unable to say what should be done instead. They call for a reappraisal of foreign policy, better education at home and abroad, more care for the plight of the poor. All fine and good; but most Americans would find these ideas perfectly compatible with fighting fiercely to defeat Osama bin Laden.

But stopping the war is not really the main aim of the movement, says a THC spokeswoman rather hurriedly. The main focus is more local, such as the need for San Francisco to take over its electrical utility. That proposal seems pressing enough in the light of California's power crisis (remember that?). Its connection to the war in Afghanistan looks pretty dim.

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The economy

A clash of wills

Oct 25th 2001 | WASHINGTON, DC
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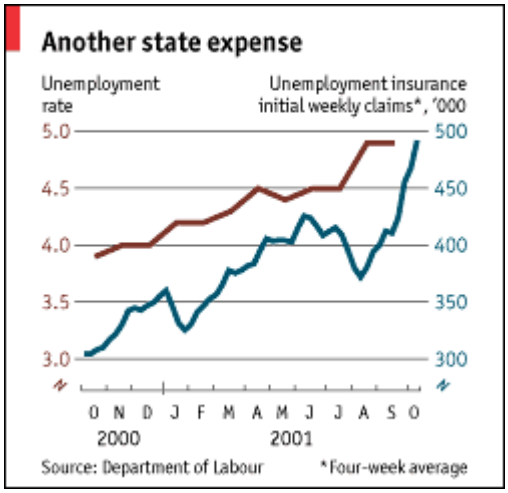
Boost, says Washington. Sorry, reply the states, how can we?



FISCAL stimulus is the rage in Washington these days, as Democrats and Republicans fall over themselves with proposals to revive the economy. On October 24th the House of Representatives passed $100 billion of (mainly corporate) tax cuts. Top senators want to spend money on unemployment benefits and subsidies for health-care premiums. There is argument about how best to do it, but no one doubts a big budget loosening is on the way.

In virtually every state capital exactly the opposite is happening. The slowing economy is pushing many state budgets into the red as tax revenues plummet. But, unlike the federal government, all but one of the states are legally bound to balance their books. With deficits forbidden, state politicians are being forced to cut spending and even raise taxes. In effect, they are being required to undermine what the people in Washington are trying to do.

The states are an often forgotten but essential part of America's fiscal system. Together they spend around $1 trillion a year, just over half as much as the federal government, while employing considerably more civilians. For most of them, revenues come primarily from two sources—income taxes and sales taxes. As the economy has stalled, these revenues have been hard-hit. Between April and June, state tax revenues grew at their slowest pace for eight years. Although the final numbers are not yet available, they probably fell between July and September. At the same time, a slower economy pushes states into spending more, particularly on Medicaid, the health-care programme for poor people. Already ten states say their Medicaid spending is above budget. It will rise much more as unemployment increases.

Things have got even worse since September 11th, and virtually every state has revised its budget figures downwards in recent weeks. Scott Pattison, of the National Association of State Budget Officers, reckons that the states face a joint deficit of at least $14 billion in this fiscal year (which for them ends next June 30th). Others reckon it could easily reach $20 billion.

New York, for instance, now expects a deficit of $3 billion, or 7% of its general fund. Hawaii, accessible only by air and relying on tourists for a quarter of its GDP, is in dire straits and has been put on credit watch by bond-rating agencies. Its governor has called a special session of the legislature to deal with what he calls the worst crisis in the state's history. Florida, which has no income tax and relies on sales taxes to pay for 70% of its operations, is also in trouble as tourists stay away. The Florida legislature began a special session this week to decide how to plug a $1.3 billion hole in its $48 billion state budget. Even states that were in good shape only a few months ago are looking ropey. Maryland, which ended fiscal 2001 above budget, now has a big shortfall.

The states have three main ways of dealing with this red ink. They can raise taxes, dip into their “rainy day” funds, or cut spending. So far, most of them have not raised taxes (though North Carolina, which was in trouble long before September 11th, recently approved several tax increases, including a temporary rise in the sales tax as well as more tax on alcohol and satellite televisions).

The states' rainy day funds amount in total to around $30 billion, more than enough to cover this year's likely deficit. In Ohio, the governor wants to draw down $300m of a $1 billion fund. But with huge uncertainty about the length and severity of the economic downturn, most states are loth to spend too

much of their reserves.

That leaves spending cuts, and most states are concentrating on those. Cutting capital spending is an obvious place to start: Washington state has frozen $400m in public-works projects as part of its effort to slice $1 billion from a $12 billion discretionary budget. But in most cases the cuts go much further, and mainly hit education and social services for the poor. More than half of Florida's $1.3 billion budget cuts are likely to come from schools and colleges.

Unfortunately, spending cuts are the most contractionary form of budget belt-tightening, since they result in a direct loss of economic activity. (When taxes are raised, people may reduce their saving, rather than cut their spending.) Moreover, state spending cuts tend to hit poorer Americans hardest: exactly the people whom the federal government is trying to persuade to spend more.

Besides, the federal government's stimulus policies could actually make things worse, by reducing states' tax revenue even further. As Iris Lav of the Centre on Budget and Policy Priorities points out, the stimulus package passed by the House of Representatives contains provisions to boost corporate investment by allowing firms to count a share of their investment costs as expenses. These provisions could reduce state revenues by $5 billion a year for the next three years, because 44 of the 45 states that have corporate income taxes use the federal rules to calculate their own tax bills.

Things do not have to be this way. Washington's budgeteers could easily include in their stimulus packages policies that helped the states. Richard Nathan, director of the Rockefeller Institute of Government, suggests temporarily reintroducing an old revenue-sharing arrangement through which the federal government distributed money to states and local governments between 1972 and 1986. In effect, the federal government would simply send a one-off cheque. Ms Lav suggests increasing the share of Medicaid costs paid by the federal government. This would be administratively easy and would allow states to shift money elsewhere.

Alas, few in Washington seem to care much about state finances. Republican law makers in particular seem far keener to cut taxes than to spend more money, whether on the states or anything else. Unfortunately, this myopia will mean a less effective federal stimulus and a lot of unnecessary fiscal pain for the states.

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About sponsorship

The Seattle mayor's race

No time to plod

Oct 25th 2001 | SEATTLE, WASHINGTON
From The Economist print edition

The livelier man looks like winning

ON A clear October day, Seattle still seems a postcard-vendor's dream. The sun glints on glass-covered towers; the blue sky shades into the darker blue of the salt water of Puget Sound; the mountains to the east and west wear a thin veneer of autumn snow. But the people of Seattle are not in dreamlike mood.

The collapse of airliner sales, one of the consequences of September 11th, means that the Boeing company may soon be laying off something like 30,000 workers. Seattle's port is getting less international trade. The city is clogged with traffic, and a long-planned light-railway system has proved too expensive. Local people, who used to relish Seattle's claim to be one of America's most civil cities, still flinch at memories of the World Trade Organisation riots in 1999 and last February's smaller but still messy violence during the Mardi Gras celebrations.

Predictably, the voters turfed the mayor, Paul Schell, out of office in last month's primary vote (he unwisely admitted to sleeping through the Mardi Gras trouble). The two men who are competing to succeed him in November 6th's election—both of them Democrats, in this habitually left-leaning city—are Mark Sidran, who has been the city's chief attorney since 1990, and Greg Nickels, a long-time local politician.

One thing they disagree about is the plan for a 21-mile, $4.3 billion light-rail system. Mr Nickels has long supported it, and has run its finance committee. But the project is $1 billion over budget without an inch of track on the ground, and has now been reduced to a 14-mile, $2.9-billion line designed to run from central Seattle to near the region's main airport (but not, oddly, all the way). In the race for the mayor's job, Mr Sidran won an early lead by criticising the scheme as too expensive and not properly thought through.

But the bigger disagreement is about the “Seattle Way”. Ever since 1969, when Wes Uhlman became mayor, the city has prided itself on settling matters by consensus. Almost every big decision is preceded by “neighbourhood forums” and careful coalition-building. An admirable idea, no doubt; but, as time has passed, the decision making has tended to get lost in a maze of meandering talk.

Mr Nickels argues that the “Seattle Way” is still fine, provided the city has a mayor (he means himself) who can get things moving. Mr Sidran, on the other hand, thinks it is time for Seattle to shed what he sees as its provincial ways, and elect a leader who will make decisions even at the risk of alienating people. As the city attorney, he has backed “civility” laws and impounded cars owned by people with suspended driving licences. Critics said that these measures hurt racial minorities and homeless people. But the civility laws have cleaned up some seedy parts of downtown Seattle, and the crackdown on unlicensed motorists has cut courtroom congestion and let policemen get on with more important work.

In a normal election, Mr Nickels—the more traditional sort of Democrat, with support from the trade unions and from popular Norm Rice, Seattle's mayor from 1989 to 1997—would have a clear advantage. But this is not a normal election, and a poll by KING-TV released on October 23rd showed the race to be a statistical dead-heat. It is the first time in 64 years that the incumbent mayor has not survived the primary. After four years of what many saw as a feckless mayorship, Mr Sidran's call for strong leadership and a break with the past has undoubted appeal. He has the endorsement of Washington state's current governor (and three previous ones), and of both of Seattle's daily newspapers.

He also has a sense of humour, a valuable quality these days. Asked what he would do on his first day in office, earnest Mr Nickels said he would station tow-away trucks at key crossroads to prevent minor accidents from blocking the traffic. Not a bad idea, but not exactly attention-catching. Mr Sidran, asked

the same thing, cocked an eyebrow and said: “Well, of course, I'll be on my way to Disneyland.”

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About sponsorship

Religion and advertising

Utah's holy war

Oct 25th 2001
From The Economist print edition

Greg Schirf

More than one wife, okay for some; more than one beer, be careful

GREG SCHIRF, the founder of Wasatch Beers of Park City, Utah, is having a headache over the advertising of his company's latest creation, Polygamy Porter. Together with the associated Squatters brewery, the firm has been tapping into the local Mormon culture to promote its brew; Mormons make up about 70% of Utah's population. Earlier radio ads featured Mormon missionaries encouraging people to baptise their taste buds; St Provo Girl beer is named after Provo, Utah, the city that contains the Mormons' Brigham Young University; the Polygamy Porter campaign asks, “Why have just one?”

Although Mr Schirf says he is not out to offend anyone, just have fun and sell beer, he receives occasional protests from a few stern Mormons. But this month the Utah Department of Alcoholic Beverage Control (UDABC) announced that using religion in advertising would not be permitted. Wasatch Beers felt hard done by.

Until last summer, advertising any alcohol other than light beer was strictly prohibited in Utah, one of 18 states that control the distribution and price of liquor. This meant no ads on billboards, radio or magazines. It also meant that restaurants had to hide their wine bottles and were not allowed to have wine lists on their menus. Waiters could offer only fruit juice or soda water with food, unless customers specifically asked for something stronger. The only places enjoying freedom of spirit—so long as it stayed behind closed doors—were private clubs. So, in 1996, thirsty residents sued the state.

A few years of legal wrangling later, a federal court ruled that all this was unconstitutional, and should therefore be ignored until the lawsuit was sorted out. So last summer the UDABC scrapped its old rules and decided that, until more liberal ones were on the books, all types of booze would be equal when it came to advertising: they could all enjoy light beer's relative advertising freedom.

Then, a couple of weeks ago, when the new rules were nearly ready, a provision banning the use of religious themes suddenly appeared. According to the UDABC, this was not aimed at Wasatch Beers. Earl Dorius, the department's compliance manager, says it was borrowed from the “good taste” section of the code of practice for advertising produced by the Distilled Spirits Council of the United States.

Unfortunately, the UDABC's good-taste afterthought hit a few snags. The religious-ban decision was taken over the telephone, a possible violation of Utah law, and the department was sued for being too secretive. In addition, the UDABC soon realised that sacramental or kosher wines could suffer, not to mention beverages such as the Christian Brothers' brandy.

It apologised for misbehaving, and the whole idea was dropped. If all goes well, the new rules should be adopted by December 4th. Time to celebrate for Wasatch Beers? Not yet. The billboard company is now refusing to run the Polygamy Porter ads. “Bad taste,” it says.

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Lexington

America the sensible

Oct 25th 2001
From The Economist print edition

The country is more rock-ribbed than outsiders think

TO JUDGE by some accounts, especially in the foreign press, America is shivering on the edge of hysteria. The *grandes dames* of Georgetown's dinner-party circuit are holed up in safe rooms, their children and servants decked out in nice new gas masks. The Pooh-Bahs of the New York media are dosed up on Cipro and psychotherapy. And the masses are too terrified to do anything other than pop pills and watch television. Quite unlike the Brits, who cheerfully endured the Blitz while singing choruses of “Knees up Mother Brown”, America is suffering a collective nervous breakdown.

The truth is much more interesting. It is that America's response to the first sustained terrorist attack on its soil is balanced, level-headed and sensible. A country that specialises in junk television and risible lawsuits is proving that, when it comes to serious matters, it is quite capable of being grown up.

This is not to say that everybody is behaving with icy calm. A leading bodyguard school is doubling its enrolment and is opening another branch to cope with the surge in demand. The media are so overheated that big-name news anchors have taken to interviewing each other. But in a country as big and rich as America there are always going to be plenty of people with more money than sense. And for once the media have some excuse for over-reacting: media celebrities are among those in the eye of the storm. (Tom Brokaw, the NBC news anchor, “actually saw” the anthrax-laden letter that was sent to him, according to his assistant.)

In general, Americans are taking the present unprecedented risks in their stride. There is a certain amount of adjustment, to be sure. Why not avoid unnecessary flights when terrorists are threatening to unleash a “storm” of aircraft on the country and airline security remains woeful? But people are continuing with their essential business.

It is still almost impossible to get a reservation at the best restaurants. Anyone wanting to fly home for Thanksgiving had better book now. Sunniness spreads to the polls: one published on October 23rd by CNN/*USA Today*/Gallup shows that the percentage of Americans describing their mood as “good” has fallen by only five percentage points since last January. Two-thirds say anthrax does not worry them. Although 72% disagree with the idea that it is their patriotic duty not to be afraid (they will be afraid if they damn well want to be), 65% think there is no good reason to be afraid of terrorist threats.

Most people have a fairly reasonable appreciation of the risks they face. Only about 1% of the

population, for example, reports that somebody in their family has purchased Cipro, the anti-anthrax drug. The amount of anxiety in the air rises and falls with the news. When it looked as if the only form of anthrax people were likely to get was the easily treatable skin variety, there were jokes about “anthrax envy”; now that two more people have died from the lung form of the disease, a more sombre mood has descended. Anxiety diminishes the farther away you go from New York and Washington, the two cities hardest hit by terrorism. There are probably people in the mid-west who still think that Anthrax is just a rock band.

This level-headedness is evident in almost every aspect of America's thinking about the war. Americans are not normally famous for their patience. But they were happy to give George Bush all the time he needed to prepare for military action in Afghanistan, and they also look quite a bit readier to cope with the frustrations of a long war than some of America's allies. Americans are even less famous for their tolerance of government, especially when it fails to work. But the government's clumsy handling of the anthrax threat has done nothing to sour the present wave of public support for the Feds. People realise that, after September 11th, there is no alternative to government action to deal with the problems being unleashed by terrorism.

For Arabs, understanding

Rather than railing against the Islamic world, most Americans are desperate to understand it. The best-seller lists are full of books on Islam, the Taliban and the Middle East. University students are crowding into courses that touch on the current crisis. Washington's Middle East Institute reports that applications for Arabic courses have doubled. Most surprising of all, Muslim clerics say that the number of conversions to their faith has quadrupled since September 11th. Almost half the population tells pollsters that it has a “generally favourable” opinion of Islam, and almost 90% say that the terrorists are part of a radical fringe that has nothing to do with mainstream Islam.

And, praise be to tolerance, there has been no serious backlash against Arab-Americans. To be sure, there have been a few horrific murders and a certain amount of harassment. But most people, from George Bush down, have gone out of their way to recognise that the behaviour of a few nut-cases proves nothing about an entire ethnic group. One Moroccan immigrant has told Lexington that he feels “blown away” by the way America has treated him. He had feared the worst after September 11th; he got the best, with people solicitous about his well-being and curious about his faith. He feels “grateful” and “amazed”.

There is no guarantee that the level-headedness will last for ever. Another big act of terrorism might tip the country into hysteria. Maybe a long casualty list from Afghanistan could change things, though the odds are that this newly steady America can take even that.

Are Americans concerned? Certainly. Are they taking precautions? You bet. But are they in a state of tight-sphinctered panic? Not a bit. The whingers who reached for their lawyers when their coffee was too hot have seen the light. The can-do pioneers who tamed a wild continent and then helped to win three world confrontations have not disappeared after all.

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Nicaragua's election

Ortega's return?

Oct 25th 2001 | MANAGUA
From The Economist print edition

AP

Daniel Ortega may become Nicaragua's president again. And the United States is, once more, out to stop him

Get article background

IT IS like the sequel to a 20-year-old movie, with many of the same actors but an extra dash of surrealism. The star (or villain): Daniel Ortega, ex-president of Nicaragua, now sporting a paunch and a bright pink shirt instead of the combat fatigues and black-and-red banners with which he and his left-wing Sandinist revolutionaries took power in 1979. Arrayed against him are officials of America's State and Defence Departments. Some of them had jobs in the administration of Ronald Reagan, which tried to unseat the Sandinists by sponsoring the *contras*, a group of terrorists (or freedom fighters). Albeit this time without violence, they wish to prevent Mr Ortega from returning to power, a decade after he was voted out, in a presidential election due on November 4th.

Hence the pink shirt. It is the campaign colour of Mr Ortega's Convergence alliance, dominated by the Sandinists but augmented by a large bunch of improbable hangers-on. They include the Christian Democrats, whose leader, Agustin Jarquin, was jailed six times by the Sandinist regime for political agitation, and is now Mr Ortega's running-mate. Also present are many former *contras*. “We fought each other for so long, now the only thing we can do is be allies,” explains Justo Pastor, a battle-scarred senior ex-*contra*, before revealing that he has been promised a vice-minister's job if Mr Ortega wins.

But Mr Ortega's broad coalition does not impress the American government. Nor does his talk of reconciliation with the United States, nor his promise not to repeat the socialist economic mismanagement of the 1980s and to resolve the thousands of outstanding claims by people whose property was seized and then, at the end of Mr Ortega's rule, sold for token sums to Sandinist sympathisers. With increasing frequency in recent weeks, officials from Colin Powell, the secretary of state, down have worried aloud about the Sandinists' former and maybe present links with terrorists, and their unreformed politics. “Ortega still sees [Fidel] Castro as the shining light, as the example to be emulated in the hemisphere,” says Lino Gutierrez, the acting assistant-secretary for the Americas.

A campaigning ambassador

American intervention goes beyond words, too. The American ambassador in Nicaragua, Oliver Garza,

has been pointedly turning up to campaign events with Enrique Bolaños, Mr Ortega's opponent from the ruling Liberals. After a drought this year, the United States has given over four times as much aid to Nicaragua as to Honduras, which was more affected by the disaster. “Maybe they think that hungry people will vote for Ortega,” says an American aid worker.

In May, two American congressmen met Noel Vidaurre, the presidential candidate for the Conservatives, the third force in the election, and urged him to pull out so as not to split the anti-Sandinist vote. Some weeks later Mr Vidaurre quit. He says the Americans did not put pressure on him, but that his party leaders had lost interest in winning. Whatever the truth, the candidate who replaced him has since lost most of his voters to the Liberals. Most polls still put Mr Ortega in the lead, but only narrowly. A tight race and a disorganised electoral authority mean that the voting is more likely to be followed by ill-feeling than by a clear, quick result.

Most Nicaraguans, except the Liberals who benefit, say the Americans are unduly nervous. “There is not much chance that Sandinism can revive the history of the 1980s,” says Mr Vidaurre. “They know Nicaragua needs international financial organisations to survive. They know the United States' influence on these institutions is decisive.” Others think that America's heavy-handed tactics could backfire. “This policy is the Sandinists' best friend,” says a European diplomat in the capital, Managua. “It will probably mean they get more votes than otherwise.”

Either way, the choice facing Nicaraguans is a poor one. Mr Ortega has kept a tight grip over the Sandinists, blocking new ideas and new leaders, causing many moderates to leave the party. As for the ruling Liberals, the outgoing government of President Arnoldo Aleman has faced many allegations of corruption. Moreover, the two parties colluded last year in a pact to give them joint control of the supreme court, electoral council and auditor's office (as a result, Mr Jarquin ended up in jail again). The electoral council has subsequently rigged the rules to prevent several smaller parties from taking part in the election. In choosing their candidates, both of the big parties used procedures that were biased against reformist challengers.

Whoever wins will face some big obstacles. Mr Ortega will have a hard job persuading investors, and the United States, that he has reformed. Mr Bolaños, despite being vice-president in the current government, is widely considered to be honest, and has promised to crack down on corruption. But he will struggle to loosen the grip of Mr Aleman, who will have a guaranteed seat in the National Assembly until 2006. “If Ortega wins, there will be economic chaos. If Bolaños wins, political chaos,” says Carlos Chamorro, the editor of *Confidencial* magazine.

Nicaragua cannot afford chaos. If it is to fulfil the conditions of proposed debt relief from rich countries, which could wipe out over half of its $6.2 billion foreign debt (about three times as large as its GDP), the new government will have to exercise economic discipline, as well as cutting public spending to rein in a galloping internal debt. Mr Ortega has promised more social spending. But Silvio Conrado, his chief economic strategist, plays that down: “Whoever is in government will have practically zero room for manoeuvre.” Trapped by its past, Nicaragua looks a long way from a happy ending.

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Mexico's new airport

Time flies

Oct 25th 2001 | MEXICO CITY
From The Economist print edition

The planners make an agonising choice

TIME, it is often said, has a different meaning in Mexico from elsewhere. Perhaps that is why Mexican officials have happily spent 30 years discussing where to put the capital's proposed new airport. This week, the transport ministry at last decided. It will be built on the dried-up bed of Lake Texcoco, and not near Tizayuca in Hidalgo state.

Although formal study of the two sites began only in 1998, the need to relieve pressure on Benito Juarez, Mexico city's existing airport, had been clear since the late 1960s. It handled 21m flights in 2000, and traffic was expected to double in the next 15 years. It is surrounded by urban sprawl, making further expansion impossible.

Of the two options considered, Texcoco is the better one for passengers, airlines and taxpayers. It is only around 30km (20 miles) from the city centre, while Tizayuca is nearly 80km away. Tizayuca would have handled only international flights, with Benito Juarez taking domestic ones, meaning lengthy transfers between the two. Texcoco, with three main runways, will take both, and handle up to 90m passengers a year. The estimates suggest it will be 30% cheaper to build than Tizayuca. It could be ready by 2005.

But the choice is bad news for some species of migratory birds, which environmentalists say will lose their habitats. Scientists consulted about the project said each site would do a similar degree of environmental damage.

The Mexico state government says it will create new reserves, but that is not enough for some environmentalists. They say they will take the case to NAFTA's Environmental Co-operation Commission. Nor does the plan please Andres Manuel Lopez Obrador, mayor of the Federal District, the inner core of Mexico city. He says it will put added strain on the city's shrinking water supply. He plans to challenge the decision in court. An end to the long wait for the new airport may not be in sight yet.

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Venezuela's foreign policy

Taking sides

Oct 25th 2001 | CARACAS AND LONDON
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A row over terrorism shows the limits of Hugo Chavez's revolution

RULING the largest oil-exporter in the Americas has long given Venezuelan presidents expansive ambitions. So it is with Hugo Chavez. For the past three weeks he has been ricocheting around the world like a pinball, visiting a dozen countries, some added to his itinerary en route. His aim: to try to persuade fellow oil-producers—both within and outside OPEC—to shore up collapsing oil prices by cutting production. He seems to have had little success.

Although there can be no doubting Mr Chavez's energy, nor his cheery charisma, a broader question hovered over his latest trip. Since oil makes up the bulk of Venezuela's exports—four-fifths last year—he is pursuing a legitimate national interest in trying to boost its price (something he helped to achieve in 1999). But his "revolutionary" foreign policy also seeks a "multipolar" world (read: one not dominated by the United States). That has taken him to some rough places: Iraq last year, and Libya and Iran this month. The last two, of course, are now sort-of-allies of the United States in the war on terror. Even so, after September 11th, Mr Chavez's policy looks like a riskier enterprise.

The president was quick to condemn the attacks on America. In London this week, he said that his government was co-operating with the United States, sharing intelligence and scrutinising bank accounts. But his trip was marred by a row, amplified by the media back home, over Ilich Ramirez, better known as Carlos the Jackal, a Venezuelan revolutionary who kidnapped OPEC oil ministers in Vienna in 1975. Having been captured in Sudan in 1994, he is now serving a life sentence in solitary confinement in a French prison.

Mr Chavez provoked a storm two years ago by writing an emotive letter to Mr Ramirez, expressing "profound faith in the cause and in the mission". Venezuela's government has said that Mr Ramirez should be repatriated, a claim Mr Chavez repeated this week (though not to French officials, he said). In Caracas, meanwhile, Jose Vicente Rangel, the defence minister, added that Mr Ramirez could not be considered a terrorist unless tried and sentenced in Venezuela.

As a result, Venezuela's ambassador to Washington was summoned to the State Department to explain his government's stance on terrorism. And General Lucas Rincon, the armed-forces commander who had been accompanying Mr Chavez, flew back to Caracas to contradict the defence minister (in theory, his boss). A terrorist was a terrorist wherever he was convicted, said General Rincon. He added that the armed forces were "100%" behind the United States in the war against terrorism.

Mr Rangel's comment was "a bit naive", Mr Chavez admitted to *The Economist*. It seemed especially so after Carlos then gave an interview from his French prison cell to a Venezuelan newspaper in which he expressed full support both for Mr Chavez and for Osama bin Laden.

The Americans know that Mr Chavez is sympathetic to several governments and organisations on its list of "terrorists", starting with Colombia's guerrillas. But Mr Chavez also seems aware that he now has less room for manoeuvre. He has repaired his relations with Colombia's government, for example. This week's row also showed that the armed forces have a rather different view of foreign policy from their president's. Mr Chavez's revolution would seem to face clear limits.

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Cuba's economy

Blaming the victim

Oct 25th 2001 | HAVANA
From The Economist print edition

Few places have been hit as badly by the tourist drought

IT IS not without irony that the accidental victims of the terrorist attacks of September 11th should include Fidel Castro's Cuba, one of the United States' staunchest adversaries for the past four decades. Almost unnoticed, Mr Castro's communist regime now faces its stiffest economic challenge since the collapse of the Soviet Union a decade ago. For that, blame in part the industry to which it turned to replace Soviet subsidies: foreign tourism.

Cuba is far from alone in suffering a drop in visitors since September 11th, but it has become unusually dependent on the foreign exchange they bring. Some 1.8m tourists visited the island last year, and the industry's gross revenues of $1.9 billion outstripped its total exports of goods (worth $1.7 billion). Recently, however, at least 20 hotels have closed, taxi drivers are being laid off, and restaurants are empty. Don't panic, says Ibrahim Ferradaz, the tourism minister: some of the hotels are merely shut temporarily for renovation, foreign investors are planning new ones, and the tourists will soon return when they realise that Cuba is a haven of peace and security in a troubled world.

Maybe, but there are other problems. After tourism, the island's biggest source of dollars is remittances to Cubans from relations abroad, mainly in the United States. But some say that the slowing American economy, and expatriate Cubans' greater reluctance to part with cash, have led to a sharp drop in remittances. Money sent from Mexico has fallen by half, according to a diplomatic source.

All of this comes as Cuba's traditional exports are suffering, too. This year's sugar harvest was exceptionally poor, and world prices of nickel and coffee are low. On top of that, Vladimir Putin, Russia's president, announced last week that his country would close a listening post at Lourdes, south of Havana, ending 40 years of military co-operation between the Kremlin and Mr Castro's government. Apart from the blow to its prestige, Cuba will lose $200m in rent. Livid Cuban officials accuse Russia of breaking a contract and bowing to American pressure.

Officials are said to be discussing emergency economic measures. Workers have been told to prepare for further sacrifices—not easy when the average wage is less than $20 a month. Mr Castro has got out of plenty of tighter corners. But his regime appears to be preparing for hard times.

The government was quick to condemn the September 11th attacks. It says that since it no longer promotes revolution abroad, it should be removed from the American list of “terrorist states”. But on the other hand Mr Castro and the state-run media have criticised the American attacks on Afghanistan. They claim that Cuba has long been the victim of American-inspired terrorism. A million demonstrators were bused to Havana's Revolution Square earlier this month to commemorate a 1976 attack by two Venezuelans (CIA-backed, say the Cubans) on a Cuban commercial jet which killed 73 people. Mr Castro has always blamed the United States for most of Cuba's problems. But this time that rings a bit hollow.

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Canada's right

A hard winter

Oct 25th 2001 | OTTAWA
From The Economist print edition

Two vacancies, and no obvious leaders

THESE ought to be good times for Canada's right-wing opposition. After all, the economy is slipping towards recession—prompting the Bank of Canada to order a surprise three-quarter-point cut in interest rates on October 23rd—while the Liberal government's response to the September 11th terrorist attacks has at times seemed clumsy. Even so, the right can still be relied upon to be its own worst enemy.

The Alliance, the largest right-wing force in federal politics, is agonising over whether to replace its newish leader, Stockwell Day, a decision it will not take until a convention to be held no earlier than March. Meanwhile, the Conservatives have lost one of their more powerful provincial leaders: Mike Harris, the premier of Ontario, abruptly resigned this month. At least four members of his cabinet are likely to take part in a tight leadership contest, swallowing energy and corporate donations that might have been spent on finding a successor to the lacklustre Mr Day.

Mr Day has clung to the leadership, despite doing badly in the general election last November, and despite a rebellion in July that saw eight of the Alliance's 66 MPs defect to the Progressive Conservative Party led by Joe Clark, a former prime minister. Mr Day has said he will step down as leader three months before the convention, but not whether he will stand again himself.

If it is serious about winning power, the Alliance might choose a more pragmatic and centrist figure, perhaps from Ontario, in the hope of achieving a merger with Mr Clark's group. But for now the larger prize for any such candidate is not the leadership of a fractured federal opposition but the premiership of Ontario, where Mr Harris easily won a second term in 1999. That in turn might help a bid for the Alliance leadership from Stephen Harper, a hardline conservative from Alberta who is young, bilingual and charismatic.

What of Ontario? A stubborn and homespun golf professional from a small northern town, Mr Harris was an unlikely leader for a sophisticated province. He was more abrasive than the centrist “red” Tories who ran Ontario for four decades until 1985. He closed schools and hospitals, merged municipalities, sacked 16,000 public-sector workers, reformed school finances and curriculums, and cut welfare benefits by 22%. That enabled him to eliminate the province's deficit while cutting taxes. This “commonsense revolution” was briefly a model for Britain's Conservative ex-leader, William Hague.

But there is a darker side to Mr Harris's legacy. He preferred confrontation to dialogue, and spread bitterness. Ontario's bouncy economy owed much to the boom in the United States. Mr Harris said he was resigning to patch matters up with his jilted wife. But he leaves his party trailing far behind the Liberals in the opinion polls, and his province facing recession. In Ontario, as in Ottawa, the job description for the new leader of the right is a demanding one.

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Afghanistan's humanitarian crisis

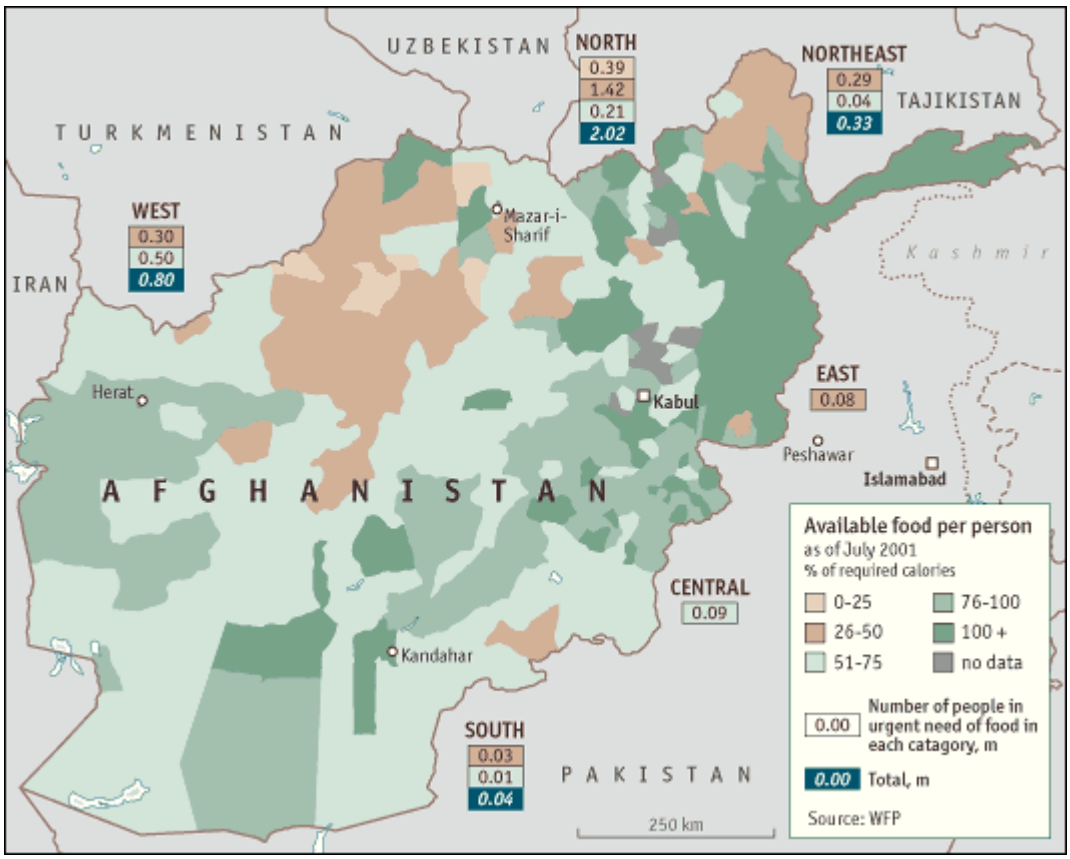
Bombs versus butter

Oct 25th 2001 | ISLAMABAD
From The Economist print edition

The race to get food into Afghanistan before winter is on

Get article background

"THE scales of justice cannot be balanced by the deaths of hundreds of thousands of innocent Afghans." So said Dominic Nutt of Christian Aid, one of six aid agencies that last week called for a pause in the bombing of Afghanistan to allow enough food to be delivered to sustain the population through the harsh winter. The UN Children's Fund says that, in addition to the 300,000 children under five who die every year of preventable causes, another 100,000 may perish this winter, in part because the conflict could complicate aid deliveries.



These are grave charges against a campaign that, its authors insist, is directed not at the Afghan people but at the Taliban government. Everyone agrees that the war is making it harder to get help to millions of people who were already barely surviving, thanks to years of drought and war. Even before September 11th, the UN thought 5.5m people, about a quarter of the population, were "at risk". The bombing has frightened people out of the cities, adding unknown numbers to the 1m within the country who have already left their homes. Without food, blankets and other essentials, many may starve or freeze.

Not all humanitarian agencies think, though, that the American attacks will make it impossible to deliver such supplies, or that, having started, they should be suspended. Several NGOs have declined invitations to join the call for a bombing pause for these or other reasons.

War between the anti-terror coalition and the Taliban has complicated relief efforts, but not principally by

placing aid agencies in the crossfire. More of the problems stem from uncertainty about the future of the Taliban, which is making them both weaker and more repressive. The modicum of order they brought to Afghanistan is breaking down, and aid agencies are among the first victims of lawlessness. There have been dozens of incidents. One Taliban faction seized a warehouse of the World Food Programme, a UN agency, in the capital, Kabul. Taliban authorities restored it to the WFP's control. Save the Children's office in Mazar-i-Sharif, a strategic northern town under attack from anti-Taliban forces, was among those looted last week. Aid workers' worst fear is that the disorder will spread.

All foreign aid workers left Afghanistan soon after September 11th. Fearing espionage, the Taliban sealed the telecoms rooms of many agencies in Afghanistan and made unauthorised contact between local staff and their foreign colleagues punishable by death. This makes it hard to plan or monitor aid deliveries. Afghan aid workers are, understandably, concerned for their own safety. When bombing started near Herat, staff left their jobs at camps for displaced people.

Some old Afghan hands are less upset. They have seen worse war and lawlessness than this, and they have seen earlier predictions of catastrophe confounded by the Afghans' resilience. America's intervention has at least turned global attention on what had been a forgotten disaster.

The top priority remains food. The WFP, which delivers food to Afghanistan and gives it to NGOs for final distribution, reckons that the country needs 52,000 tons of food a month for the next six months. It suspended deliveries from September 12th to 25th, to the fury of some NGOs, and is now racing to catch up. There is a lively argument among agencies in Islamabad about whether that is possible. Charities such as Oxfam complain that the WFP is not delivering enough food, especially to parts of the country that will be snowbound by December. The WFP says the real problem is distribution within Afghanistan. This seems to be getting sorted out. NGOs have made commitments to distribute the full amount of food that the WFP thinks is necessary, though conditions on the ground may hinder it.

The intensity of the emergency varies by region. Food is being delivered normally in most of the north-east, which is controlled by the anti-Taliban Northern Alliance. Much of the drought-hit north, where 2m people face acute shortages, has so far escaped the ravages of the attacks, but the embattled area around Mazar-i-Sharif is hard to reach.

The people most at risk perhaps are those who live in the central highlands, where 500,000 people are dependent on food aid. The WFP wants to stockpile 23,000 tons of food there before winter makes the region all but inaccessible. Oxfam, which distributes food in Hazarajat, a central region populated mainly by the Shia Hazara minority, says little has arrived. Part of the reason is that turmoil in Kabul discouraged lorry drivers from picking up food from the WFP's warehouse there. The WFP is trying a new tack: transporting food directly from Peshawar to NGOs in central districts. In a rare expression of appreciation from the aid agencies, Oxfam calls this “really good thinking”. If convoys cannot supply the area before winter, the WFP proposes air-drops. These would be from a low altitude and directly to local aid workers, unlike the high-altitude American “food bombs”, which one aid official describes as “0% humanitarian and 100% spin”.

Unicef is still getting supplies like blankets and emergency food rations through, by mule train in one case, but says that “a delay of a day could mean life and death.” Whether ingenuity can defeat anarchy depends on how much worse things get. If the Taliban fall with no new order to replace them, people will starve.

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Afghanistan

Fashion victim's fate

Oct 25th 2001 | FAIZABAD
From The Economist print edition

Rarity means riches in poverty-stricken Afghanistan

THEY are among the rarest and most magnificent animals in the world, so reclusive that filming one for more than a few moments is one of the last great challenges of wildlife television. But in the cluttered surroundings of Mr Amrutullah's souvenir shop in Faizabad, capital of Afghanistan's Northern Alliance, the snow leopard looks more like a child's tatty toy.

The shop's owner explains proudly that he stuffed “the tiger” himself. He used cotton waste and old clothes. What looks like underpants poke through a tear in the pelt, gloriously sleek and thick on a live animal, but now dusty and dishevelled. Some old red socks fill the creature's skull.

It was killed about eight months ago, Mr Amrutullah explains, by a spring trap baited with meat. He squats between two generators and a pile of blankets to draw a diagram in the mud floor of his shop, showing how the jaws of the trap caught the animal's neck. He did not do it himself, he says. That would be much too time-consuming—up to four months of patient waiting for a single kill. There are full-time leopard hunters, though, in the Wakhan corridor, a tongue of Afghan territory that stretches up to the Chinese border, and one of the most inaccessible places on earth.

There are thought to be only 3,500-7,000 snow leopards left in the world. One wildlife charity believes Afghanistan may have only 100. But conservation efforts have practically stopped during 20 years of civil war. The rewards for hunting are huge. Unscrupulous fur-fanciers will pay up to $50,000 for a coat of (properly cured) snow leopard. In the capital of opposition-controlled Afghanistan, Mr Amrutullah's miserable specimen costs just $500. He expects delivery of another sometime next year.

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Central Asia

Day of the bully

Oct 25th 2001 | ALMATY
From The Economist print edition

Uzbekistan's new role worries its neighbours

THE countries of Central Asia are anxiously assessing which of them will gain and which may be the losers as a result of the war in Afghanistan. Much of their thinking turns on the role of Uzbekistan, where some 1,000 American soldiers have moved in to provide search and rescue operations for the Afghan campaign, and another 1,000 are said to be on the way. Will Uzbekistan's president, Islam Karimov, be able to turn the United States' presence to his advantage?

He has long had ambitions to make Uzbekistan the regional leader. It is at the geographic centre of the region and has the largest population: 25m out of the total of 57m in the five Central Asian states. Some Uzbeks regard the once-nomadic Kazakhs and Kirgiz as culturally their inferiors.

Mr Karimov is also seen as the regional bully. In January 2000, Uzbek border guards entered southern Kazakhstan and unilaterally marked out a 60km (38-mile) stretch of the border in Uzbekistan's favour. On several occasions, the Uzbek authorities have arrested opponents inside Kirgizstan. Uzbekistan has mined its borders with Kirgizstan and Tajikistan to deter incursions by Islamic extremists, but has not told its neighbours where the mines have been laid. A number of civilians have been killed or injured while crossing the border peacefully.

In mid-winter the Uzbeks frequently cut off gas supplies to their neighbours, usually as a result of a payment dispute. The Kazakhs have tried to even the score by disrupting the telephone service. No direct calls can now be made from Uzbekistan to Kazakhstan. One way or another, good neighbourliness is in short supply in Central Asia.

Uzbekistan's bullying, and the iron rule of Mr Karimov, may repel human-rights activists. Potential investors, however, are much more discouraged by the country's restrictions on free currency movements, which have crippled the economy. Kazakhstan has a better claim to lead the region. It has made some bold economic reforms, and the huge oil and gas reserves in its vast territory—it is by far the largest of the five Central Asian countries—have brought much foreign investment.

Could a grateful United States help out Mr Karimov with investments? He is already hopeful that the Americans could dispose of what Uzbekistan considers its greatest threats: the Taliban, of course, but also the Islamic Movement of Uzbekistan, which seeks to overthrow the Karimov government and whose fighters have been trained in Afghanistan.

Russia did not oppose the American request to put troops in Uzbekistan, but would not be enthusiastic about increased American influence in a region it considers its backyard. All the Central Asian republics were part of the Soviet Union. Should the Americans seek to hang on after the Afghan campaign is over, it would be a setback to President Vladimir Putin's long-term plan to draw them back ever closer to the Russian fold.

The sudden warming of relations between the United States and Uzbekistan also worries human-rights activists. Amnesty International gave warning this month that governments could use the war against terrorism “as an excuse to further undermine respect for human rights”.

In Uzbekistan, thousands of Muslims have been jailed, supposedly for sympathising with banned Islamic opposition parties. Amnesty says Mr Karimov may believe that America's efforts to enlist his support amount to “an endorsement of Uzbekistan's repressive and discriminatory practices”.

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Asia-Pacific Economic Co-operation

Getting a bit more serious about security

Oct 25th 2001 | SHANGHAI
From The Economist print edition

Last weekend's summit in Shanghai took an overdue step

THE Asia-Pacific Economic Co-operation forum, once mocked as “four adjectives in search of a noun”, has at last taken a cautious step towards assuming the role that Asia needs it to play. At their summit last weekend in Shanghai, 20 of APEC's 21 members—Taiwan was absent—issued a statement condemning the attacks in America and calling for better co-operation against terrorism. For an organisation that has long resisted attending to security concerns, this was progress.

AP

Fancy dress with a purpose

A forum bringing together the leaders of all the region's main economies and every major power involved in East Asia—a region worryingly bereft of any multilateral military security arrangement—is of obvious potential importance. When the United States held the first APEC summit in Seattle in 1993, President Bill Clinton hinted that one of the organisation's aims should be to strengthen regional security, but there has been great resistance to the idea. Although APEC's leaders did manage to discuss the bloodshed in East Timor two years ago, the declaration on terrorism issued in Shanghai last weekend marked the forum's first formal adoption of a security-related document.

An enhanced role for APEC is badly needed. Some of Asia's many security problems—ranging from the stand-off on the Korean peninsula to territorial disputes in the South China Sea—are discussed at the ASEAN Regional Forum (ARF), which brings together the ten members of the Association of South-East Asian Nations as well as the European Union and 12 other countries, including China, America, Russia and Japan. But because the ARF meets only at foreign-minister level, it lacks diplomatic weight. Summit meetings are also held annually between ASEAN's leaders and three north-east Asian powers—China, Japan and South Korea. But these get-togethers make little headway without the United States.

APEC's members often seem intent on giving the impression that their gatherings are little more than a symbolic display of unity. They call their summits informal and try to reinforce that message with the embarrassing ritual of donning traditional local garb chosen by the host. Many were the titters aroused by the spectacle in Shanghai of George Bush and Vladimir Putin wearing high-necked blue silk jackets dotted with floral designs.

In a region riven by suspicions and animosities and resentful of efforts by outsiders to impose solutions, APEC's informal setting can have its uses. It allows Taiwan's involvement—although not by its top political leaders: Taiwan boycotted the Shanghai meeting after China had blocked its efforts to send a retired former vice-president. China would be enraged by any attempt to discuss the Taiwan issue in APEC, but at least the scope exists for the subject to be raised in the margins.

Of APEC's members, China is among the least willing to broaden APEC's agenda or tackle security issues

in any multilateral setting, especially not one that prominently includes the Americans. Yet China is central to most of the region's security problems. Despite the displays of unity and friendship in Shanghai, many of APEC's members are worried about China's military ambitions and its growing economic strength, as well as the potential for social unrest and political instability in China that could affect its neighbours. “We are worried about what we would do if there were a flood of refugees from China,” says a nervous East Asian diplomat.

This makes it important for Asia-Pacific countries, including America, to encourage stable economic development in China while trying to draw that country into broader security discussions. Even if the APEC leaders' declaration on terrorism pulled its punches, it was a remarkable consensus given China's reluctance to discuss the issue at all and the concerns of APEC's Muslim-dominated countries—Brunei, Indonesia and Malaysia—about the military campaign in Afghanistan. “What it has shown is that economics occurs in a context,” says New Zealand's prime minister, Helen Clark, who wants APEC to widen its horizons.

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Privatisation in Japan

Götterdämmerung

Oct 25th 2001 | TOKYO
From The Economist print edition

Once again, Japan's bureaucrats are under attack

HOSOKAWA, Hashimoto, Koizumi. The names change. But the aspirations of Japan's political leaders stay the same. Curbing bureaucratic power has been at the top of almost every Japanese government's agenda since Morihiro Hosokawa took office in 1993. Equally unchanging has been the record of failure. Mr Hosokawa was gone in less than nine months. Ryutaro Hashimoto settled for cosmetic change and lost the support of the voters. Now Japan's latest prime minister, Junichiro Koizumi, is launching another assault on the bureaucrats' kingdom.

Hand-out heaven
Special corporations, ranked by annual subsidy, ¥bn

Government Housing Loan Corporation	443
Japan National Oil Corporation	363
New Energy and Industrial Technology Development Organisation	338
Employment and Human Resources Development Organisation of Japan	318
Promotion and Mutual Aid Corporation for Private Schools of Japan	315
Japan Highway Public Corporation	306
Japan Bank of International Corporation	285
National Space Development Agency of Japan	205
Japan International Corporation Agency	187
Corporation for Advanced Transport and Technology	158

Source: Japan Cabinet Office

Poor Mr Koizumi, smile the mandarins, still believes he can win. He does not lack ambition. His targets are the government's 163 “special corporations”—state-owned businesses whose interests span everything from home loans to oil exploration. On one level, Mr Koizumi is borrowing from the economic textbooks of the West. If the private sector can do the job, he says, the state should not, a principle that he wants to make the basis of his public-sector review, due by the end of December. But Mr Koizumi's fight with the bureaucrats has a deeper dimension.

This emerges from the baggage of Japanese history. The bureaucrats of feudal Japan were samurai, the old elite warrior class, who had hung up their swords during the long peace of the Tokugawa shogunate. Under the imperial restoration of 1868, these bureaucrats became servants of the emperor, who claimed divine descent. After the second world war, the new constitution, written with American help, gave sovereignty to the people. But bureaucratic presumption endured. In office, the mandarins busied themselves with economic micromanagement, helping to make Japan's mixed economy really very mixed indeed. On retirement, they “descended from heaven”, as their own saying has it, into cushy jobs in the private sector, or the myriad special corporations that mushroomed after the war. Their relationship with the public is captured, with characteristic Japanese economy, in the phrase *kanson minpi*—respect for authority, contempt for the masses.

Only extreme unaccountability can explain the operation of these special corporations. The government forks out more than ¥5 trillion ($41 billion) a year in subsidies just to keep them afloat. Yet up to now, not a single former bureaucrat has resigned to take responsibility for this epic mismanagement. On the contrary, the mandarins are not even prepared to admit there is anything wrong.

The ex-bureaucrats reward themselves handsomely. By regularly shuffling from job to job among the public corporations, in just ten years top civil servants can earn $1m or more in lump-sum retirement pay alone, half of which is exempt from income tax. Because bureaucrats retire in their mid-50s, and can serve on the public corporations well into their 80s, some become seriously rich.

Mr Koizumi's reforms, concede aides, have quickly become an uphill struggle. So he has singled out seven corporations for special attention. Although, with a couple of exceptions, they are not the most heavily subsidised, these corporations have been chosen for what they symbolise. Four of the seven build and manage roads and bridges, an activity that has come to represent everything that is wrong with Japan's political economy.

According to its latest annual report, the Japan Highway Public Corporation manages 6,851km (4,280

miles) of tolled motorways, whose charges are among the most expensive in the world. Another 4,669km of motorways are planned, of which 2,213km are already under construction. Because these new motorways will run through mountains and round cities, they will cost ¥5 billion or more per kilometre to build, suggesting total outlays of at least ¥25 trillion. Unlike existing motorways, the construction costs of future roads cannot be recouped through toll fees, explains the corporation, because traffic is expected to be light in the mountains.

The Japanese government is already the most heavily indebted in the world. Yet its bureaucrats insist on a ruinous road-building programme that has the taxpayer shelling out for more road building in 2001 than in 1969, when Japan needed many more motorways and its economy was growing at 10% a year. At first, the bureaucrats flatly rejected Mr Koizumi's push to privatise these road-building enterprises. They have since agreed, but crucial issues remain unresolved.

First, the mandarins want to be in charge of their own reform, a principle that the politicians have honoured in all administrative reforms up to now. Mr Koizumi says this is nonsense: the task of drafting privatisation plans must go to an independent authority. Second, the bureaucrats say they will accept privatisation only if existing road-building plans do not change. Again, Mr Koizumi disagrees. Unless the corporations' finances are sustainable, no one will buy their shares.

Mr Koizumi wants answers by the end of November. The bureaucrats are appealing, in time-honoured fashion, to the ruling Liberal Democratic Party's road lobby. With Mr Koizumi visibly wearying, the fight is swinging against him. But even if Mr Koizumi's reforms do fail, the mandarins have surely entered a long twilight in Japan. The old deference to authority is giving way to more assertive attitudes. The era of fast growth is over, and recession and financial crisis have undermined the bureaucracy's reputation for competent rule. The political resolve for reform endures because the voters have changed, and now they demand it. Whatever plans they have for Mr Koizumi, the mandarins cannot escape that uncomfortable truth.

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Israel and the Palestinians

Pull back the tanks, says Bush to Sharon

Oct 25th 2001 | JERUSALEM
From The Economist print edition

EPA

Israel's assault on Palestinian cities

Get article background

"IMMEDIATELY, in English, doesn't mean at once," Shimon Peres explained in Hebrew to Israeli journalists in Washington on October 23rd. "It means as soon as possible." The day before, the American State Department had told Israel to end its armoured incursions into six Palestinian towns "immediately". But this, Israel's foreign minister explained, was meant "not in the chronological sense but rather in the intentional sense."

Barely had Mr Peres concluded his lesson in creative semantics than he was called to an unscheduled meeting with President George Bush, who told him in semantically unequivocal terms that the seizure of these cities was exactly what America does not need at this stage in the Afghan war. Mr Bush tempered his anger with the grudging recognition that Israel needs a face-saving interval between reprimand and response. Even so, barring some new dramatic event, Israeli forces are expected to be out of most of the Palestinian towns by the weekend.

During the week the army continued its fierce pursuit of suspected militants, while the government cranked up its propaganda effort. The operation had been a success, spokesmen said, in that some 20 alleged terrorists had been arrested by special forces and another 20 killed or injured. They expressed relief that the United States and Europe were pressing Yasser Arafat to take vigorous action, both against the Popular Front for the Liberation of Palestine (PFLP), the left-wing group that assassinated Rehavam Zeevi, an Israeli minister, on October 17th, and against the Islamist organisations. But Israeli diplomats, instructed to draw an analogy between Mr Arafat's Palestinian Authority (PA) and the Taliban, made little headway against the White House's stern dismissal of that comparison.

America's very public intervention, after a long weekend of seeming indifference while the president and the secretary of state were off in China, came as a shock to Israel's prime minister, Ariel Sharon. An Israeli newspaper reported that privately Mr Bush, apprised of civilian casualties in the West Bank, had suggested that the Israelis could "go to hell".

Many in Washington, as indeed in Jerusalem, suspect that Mr Sharon calculated, or at least hoped, that by sending in the tanks he could topple the PA. The Palestinians certainly believe this. But many also believe that there is a worse danger to the authority than an Israeli reconquest from without. They fear

that the continuation of punitive Israeli policies will ensure the collapse from within of what remains of Mr Arafat's government.

A strategy to bring about such a collapse is, they argue, behind Mr Sharon's insistent demand that Mr Arafat must extradite to Israel the people who killed, and ordered the killing of, Mr Zeevi. In seven years of peace and security co-operation with the Israeli army, Mr Arafat has never once extradited anybody to Israel. He cannot do so now, with his people on the cusp of war, and enraged against him.

The Palestinian leader's first response to Mr Zeevi's killing was anger at this open defiance of his ceasefire orders. He outlawed the PFLP's military arm and arrested around 30 members. But anger became fear as his people, and his regime, were rocked by the most savage Israeli assault since the PA was established in 1994.

Over seven ferocious days, more than 40 Palestinians have been killed, including a ten-year-old girl in her classroom near Jenin, and a young mother of nine near her home in a Bethlehem refugee camp. Bethlehem, pictured above as tanks entered the city, rapidly became a war landscape, with palls of smoke hanging above its camps and tanks squatting on the forecourts of its five-star hotels. While carrying out a particularly fierce assault on a village near Ramallah, Israel blocked all outsiders, including ambulance-drivers, from entering.

Palestinians fired their guns at the Israeli tanks reoccupying their cities. They fired more randomly, too. An Israeli civilian was killed hiking in occupied territory. On October 22nd a Palestinian from Bethlehem unloaded his pistol in a commercial part of West Jerusalem, wounding four Israelis. But the Palestinians' fury and frustration were also directed at their own leaders for bringing them to such a pass.

There have been demonstrations in Ramallah by all the Palestinian factions (including Mr Arafat's Fatah) against the PA's “political arrests” of PFLP members. There have been calls for a government of national unity to replace the one-man show that currently runs, or rather does not run, things in the Palestinian areas.

And 30,000 people attended the funeral of Atef Abayat, the leader of Fatah's al-Aqsa military arm, who with two colleagues was blown up in his car near Bethlehem on October 18th in what was almost certainly an Israeli-planned assassination. The huge turnout was as much a protest against the PA, which had tried to arrest him, as against the military occupation that had killed him.

Mr Arafat's insistent message is that he can impose order only if Israel first withdraws from the reconquered Palestinian areas. But whether a modicum of calm will then prevail, and whether the PA's drift to collapse can be checked, depends largely on America's follow-up diplomacy after the immediate crisis is over.

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Iran and Afghanistan

Benevolent neutrality

Oct 25th 2001 | TEHRAN
From The Economist print edition

Iran and Europe start to see eye to eye on Afghanistan

EPA

Iranians turn out for Afghans under fire; official policy is more circumspect

KAMAL KHARRAZI, Iran's foreign minister, says that he, like almost everybody else, wants to see a "broad-based government" set up in Afghanistan. As a regional power with religious and cultural ties to non-Pushtun Afghans, Iran can do quite a bit to destabilise an Afghan regime it does not like. It hated the Taliban, and so spent the past seven years arming the Northern Alliance. But lured by the hope of influencing the next Afghan regime, and with foreign statesmen and diplomats beating a path to Mr Kharrazi's door, Iran's views seem to be falling into line with proposals put forward by America and Europe.

However, at least until now, Iran's leaders have balked at the idea that Muhammad Zahir Shah, Afghanistan's deposed king, should return to head an interim administration. Iran fears that the ex-king's presence will remind Iranians that they have an exiled would-be king of their own: some of the riots in several Iranian cities at the beginning of this week had a monarchist flavour. But on October 23rd Mr Kharrazi, no doubt egged on by the Italian foreign minister standing at his side, carefully passed over an opportunity to oppose the former king's return.

The following day he made it clear that Iran had revised its former insistence that the toppled regime of Burhanuddin Rabbani, the Northern Alliance's political leader, should form an interim government. Instead, he referred to a "caretaker government, representative of different groups, and proportionate to their population." Iran, according to Siyavash Yaghoubi, the capable diplomat who runs the policy towards Afghanistan, wants the Northern Alliance to take Kabul, before handing over power to an interim government closely supervised by the United Nations. Iran, or so foreign envoys say hopefully, will play a crucial role in trying to persuade Mr Rabbani that he is only "part of the solution, not the whole solution."

Notwithstanding the vituperative anti-Americanism of its supreme leader, Ayatollah Ali Khamenei, Iran's pragmatic neutrality is becoming central to Afghan government-builders. The government has promised to co-operate fully with Lakhdar Brahimi, the UN's man for Afghanistan, when he visits Tehran, probably next week. Mr Kharrazi presumably advised Abdullah Abdullah, Mr Rabbani's "foreign minister", to do the same when they met on October 18th. Iran may even fudge its current insistence that the next government should have no Taliban taint: "We oppose the Taliban ideology, not its personnel," says a well-placed official.

Iran and Pakistan traditionally disagree fiercely on Afghanistan. But many of Iran's current visitors are on

their way to or from Islamabad: brokering an agreement between Afghanistan's interfering neighbours is a prerequisite to the success of any future government. Pakistan appreciated Iran's robust reaction to an attack earlier this month by a pro-Taliban mob on a Pakistani consulate near the border. Although Iran remains sardonically critical of Pakistan's former support for the Taliban, and deliberately irritates Pakistan by talking about Afghanistan to India, relations between the two countries are warming.

Iran is the largest of the countries America's State Department treats as state sponsors of terrorism, and hawkish Americans would like it included in the later phases of the anti-terrorism war. But so long as Iran's neutrality remains benevolent, such threats can be staved off.

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Arab dissent

Chance for a clampdown

Oct 25th 2001 | CAIRO
From The Economist print edition

Under cover of anti-terrorism, Arab regimes are hitting their dissidents

THE world's new-found fear of Islamist terrorism is providing several Arab governments with a new opportunity to squeeze their domestic enemies. In doing so, however, they inflame the anger that sparked militancy in the first place.

For many, the current crackdown is simply a continuation of past policy. Jordan's government, for instance, has been tightening security ever since the *intifada* broke out next door. It suspended parliament in June, and has since decreed a dozen “temporary” laws, substantially limiting the relatively liberal civic freedoms its citizens enjoy. But the trend has intensified since September 11th. Islamist groups report that several dozen of their members have been arrested, and a new edict authorises the closure of any publication deemed threatening to “public order”.

Similarly, Egypt has long been in the forefront of the war against Islamic extremism. Clobbered by the arrest of thousands of their members, the extradition back to Egypt of hundreds who had fled abroad and the execution of dozens, Egypt's two armed Islamist groups virtually ceased to function at home in recent years. The Gamaat Islamiya declared a ceasefire in 1999, while its more extreme cousin, Islamic Jihad, moved its operations offshore, notably to Afghanistan. Claiming success, the government had felt confident enough to release several thousand detainees and to reduce the number of prosecutions by the military courts, where sentences come swift and harsh and there is no right of appeal.

Punishment by military court

In the past month, however, an unprecedented 243 alleged militants have been referred to military courts. Two-thirds of them are said to be from the Gamaat Islamiya, suggesting that the state has abandoned the relative leniency showed in response to the group's ceasefire call.

Other measures also reflect the new, no-nonsense attitude. Gatherings in many mosques have been forbidden except at prayer times. Demonstrations can take place only with overwhelming official security. And the police have continued to arrest members of the non-violent Muslim Brotherhood, despite the group's declared backing for the government's policies on international terrorism.

Even non-political irritants are suffering unusual wrath. Several dozen young men, accused of rioting last month after a spate of hit-and-run accidents on the main road that bisects their village, have been sent to a State Security Court that is normally used for political trials.

In some countries, repression has not notably increased but the world's preoccupation with security, and America's need for allies, have given governments a freer hand to crush dissent. That is true of Syria. The arrest in August of ten dissidents sparked a furore of diplomatic protest, but those critical western governments have now fallen silent. In Tunisia, the human-rights movement has expressed fears of a weakening of western pressure on the heavy-handed Tunisian government.

Reawakened security concerns have prompted other wary Arab governments to co-operate with each other. Morocco and Algeria, for example, have long been at loggerheads, but last month the Moroccan police arrested a senior leader of the FIS, an Islamist party outlawed in Algeria. Similarly, countries such as Sudan, Yemen and the United Arab Emirates, once havens for Islamist exiles, have greatly eased their extradition procedures.

European governments that were once generous in granting political asylum have also grown more co-operative with Arab governments. Egypt and Algeria in particular have long complained that fugitives from their police—many of whom face death sentences at home—have sheltered behind western concern. Libya's leader, Muammar Qaddafi, said this week that if America was serious about striking those who harbour terrorists, it should bomb London, since so many wanted men have found refuge there.

That refuge is no longer safe. Britain's tightening of anti-terrorist laws is greatly pleasing to Arab governments. The arrest in London of Yasser al-Sirri, a leader of Egypt's Gamaat Islamiya, was greeted in Cairo with particular glee. Mr al-Sirri himself renounced violence after fleeing Egypt eight years ago, but continued, like other London-based radical exiles, to propagate extremist ideas via fax and the Internet.

Algeria's president, Abdelaziz Bouteflika, recently remarked that for a decade in his blighted country, “we fought alone, finding neither friends nor brothers.” Arab regimes are no longer alone in fighting Islamist extremism. But, as the bombing of Afghanistan proceeds, the extremists are also gaining new converts.

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South Africa's opposition

Divided we stand

Oct 25th 2001 | JOHANNESBURG
From The Economist print edition

The political opposition looks like falling apart

AP

Kiss of death for Leon's alliance

MANY African opposition politicians are persecuted. South Africa's Democratic Alliance (DA) is ignored. The ruling African National Congress (ANC), with four times as many seats in parliament, pays it no more heed than a lion does a mosquito. The coalition has no prospect of winning a national election, and almost no support beyond the country's various racial minorities. Now, to make matters worse, it appears to be falling apart.

The DA was born last year from the union of the two main opposition parties: the liberal Democratic Party (DP) and the New National Party (NNP), the surviving rump of the party that subjected South Africa to apartheid until 1994. It was not an easy merger. Some thought it represented the best chance of creating a serious political counterweight to the ANC. Others, such as Helen Suzman, a veteran liberal, gave warning that the union was giving "the kiss of life to a terminally ill NNP".

Instead, the NNP may be giving the kiss of death to the alliance. Peter Marais, the mayor of Cape Town and thus one of the DA's most senior holders of public office, was expelled from the party on October 19th. He is accused of corruption, and of misleading the public by claiming, apparently falsely, widespread support for renaming two streets after ex-Presidents Nelson Mandela and F.W. de Klerk. He also used public money to hire a personal spiritual adviser and to buy newspaper advertisements promoting himself. The DA's leader, Tony Leon, fumes that Mr Marais has besmirched the party's reputation, scared off donors and must go for good.

However, the alliance's deputy leader, Marthinus van Schalkwyk, fought hard to defend Mr Marais. He knew this would damage his already strained relations with his boss, as indeed it did: Mr Leon and Mr van Schalkwyk no longer talk to each other. But Mr van Schalkwyk resents the way the DP dominates the alliance, with 38 seats to the NNP's 28, and he backed Mr Marais because he is a fellow NNP man.

The squabble over Mr Marais is the latest of many. After allegations that the NNP has been dishonestly inflating its membership roll, DP members accuse their junior partner of trying to take over the coalition. They want Mr Leon to subject his deputy to a disciplinary committee, and to demand a public apology for "disloyalty". Some even want Mr van Schalkwyk expelled from the alliance.

The DA may represent only whites, some (mixed-race) Coloureds and a few Indians, but it is the only party with a shred of a chance of offering serious political opposition to the ANC. In the areas the DA controls, chief of which is the Western Cape province, it can experiment with policies the ANC rejects, such as the provision of anti-retroviral AIDS drugs to HIV sufferers. But if it cannot hang together, it may lose what little power it has.

On October 24th, Thabo Mbeki, South Africa's president, made one of his rare appearances in parliament to face questions on his much-derided AIDS policy, which downplays the importance of an epidemic that may kill a third of South Africans. It should have been easy enough to make him squirm. But Mr Leon seemed too preoccupied by his own troubles to call the government to account.

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The German economy

Holding steady, just, maybe—and maybe not

Oct 25th 2001
From The Economist print edition

AP

The biggest economy in Europe is on the verge of recession

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IT IS by far the largest economy in Europe, and it is in trouble. In the regular half-yearly report that they published this week, Germany's six top economic-research institutes declare that the economy is “on the brink of recession”. Will it fall into it? The economy is not actually shrinking, as far as anyone can tell, but since the spring it has not been growing either. Now the events of September 11th have made prospects gloomier and even more uncertain. The chancellor, Gerhard Schröder, and the finance minister, Hans Eichel, dismiss talk of recession. Yet Mr Eichel's forecasts are little different from those of the institutes: he thinks GDP will rise by only ¾% this year and by 1-1½% next.

There is no shortage of ideas on how to give the economy a boost. Mr Schröder, like other politicians in the euro area, thinks the European Central Bank should have been cutting interest rates more quickly. Maybe, but rate cuts would take time to have an effect, and a quarter-point here or there would probably make little odds. This week the ECB did not oblige; rates were left at 3.75%.

Others want Mr Eichel to relax his grip on the purse-strings. Five of the six institutes say he should bring forward the second stage of his tax reforms, including cuts in income tax, from 2003 to next year. Businessmen have pleaded for corporate-tax cuts and infrastructure spending. No, says Mr Eichel, pointing out that the first stage of the tax changes, which took effect at the start of this year, has already put some $20 billion into people's pockets. He also has a nervous eye on his budget deficit, which the feebleness of the economy has already widened. He planned for a gap of 1.5% of GDP this year. Now well over 2% looks likely both this year and next.

That is awkward. The stability-and-growth pact approved by the members of the euro zone looks for budget balance by 2004. Germany aims to achieve it only in 2006, and in the eyes of the European Commission it is one of four countries that still have work to do. More awkward still, any deliberate loosening of the budget would increase the risk that the deficit would reach 3% next year. That would make Germany liable to a fine under the pact—embarrassingly, and the more so because the stability agreement was originally a German idea.

Is the finance minister right to hold tight and hope? Of the ideas put to him, accelerating the tax reforms looks the best alternative to doing nothing. The reforms should make the economy more efficient, so it would anyway be better to have them sooner rather than later. Their second stage will cost about 0.3% of GDP, but the budgetary risk next year would be just acceptable. They might even save some jobs, no

bad idea with a general election only a year away. Unemployment is now 3.9m and set to go on rising. Mr Schröder once rashly promised to cut it to 3.5m.

Yet doing nothing could also turn out right. The trouble is that economic forecasts are shrouded in an even thicker fog than usual. The economy looked weak before September 11th, although there had been the odd sign of recovery. The attacks on America have certainly made things worse, but no one yet has any clear idea how much. Consumers have probably been spending less. Businesses are probably thinking twice about investment, and exports, so far still robust, will suffer from renewed weakness in the United States. But decent data are yet to come.

Such information as there is, though, looks pretty bad. Among businessmen polled recently for *Handelsblatt*, a financial daily, almost half expected a recession. Nastier still was the September reading of the monthly Ifo index of business confidence, published by a Munich research institute. Economists regard this index as the most reliable signal of things to come—and it was down to its lowest since 1993. The monthly drop was the biggest since 1973, the year of the first oil shock. Granted, businesses may have over-reacted, and the October figure may not be quite so bad. But it would take a big rebound to make the index look healthy. “Do we trust it?” asks Stefan Bergheim, of J.P. Morgan in Frankfurt. “I'm afraid we have to.”

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Berlin's election

Democracy, it's wonderful

Oct 25th 2001 | BERLIN
From The Economist print edition

In the city-state's election, 23% of the vote went to the heirs of communism

THEY are the direct successors of the communists who once misgoverned East Germany for their Russian masters. Yet today's Democratic Socialists could find themselves sharing power in Berlin: in the city-state's election on Sunday, they took 23% of the vote, over twice what they won soon after it was reunified in 1990.

They are now eager to form a coalition with the Social Democrats, whose 30% put them ahead of the Christian Democrats in the city for the first time in 26 years. But, with a general election not a year away, Chancellor Gerhard Schröder is not keen to see his party cosying up to the heirs of the sorry regime that kept Germany—and its capital—divided for 40 years. So Klaus Wowereit, the Social Democratic acting mayor since the collapse of the city's coalition (Christian Democrat-led, with his party as junior partner), is keeping his options open.

He would have preferred to prolong his four-month-old coalition with the Greens. But the two parties did not win an overall majority. He has now started talks with the Free Democrats, with a view to a three-party coalition. Even that would give him only a five-seat majority. With the ex-communists, he would be 13 ahead. He is also reluctant to exclude a party supported by nearly half of all who voted in the former Soviet zone of the city.

That proportion is remarkable enough: east Berliners by now are not much poorer than their west Berlin cousins. Yet, feeling they are treated as second-class citizens, they still turn to the Democratic Socialists. Even more remarkable, though, is that party's overall 23%. True, it has scored even higher in Germany's ex-communist eastern states. But to do so in Berlin, two-thirds of whose voters have no reason to feel betrayed by capitalism, is a triumph.

Much of the credit is due to Gregor Gysi, the party's founder and leader of its electoral campaign. With his self-confident ebullience, gift of the gab and caustic wit, this smooth-talking lawyer attracted voters quite unlike the Democratic Socialists' traditional ageing sympathisers. Many young voters seem to have plumped for the one significant party wholly opposed to the American bombing of Afghanistan. Many former Christian Democratic voters switched the whole way, in disillusion with the party which, until its downfall in the summer, had governed Berlin for all but two of the past 20 years.

Mired in the chaos of city-hall finance, beset by allegations of political graft and cronyism, hampered by an inexperienced and lacklustre campaign leader, the Christian Democrats scored only 24%—17 points fewer than in the city elections two years ago. The shock will go wide. The party's national leader, Angela Merkel, rushed to absolve herself of any blame. But she was already under fire, and the rout will make it even harder for her to become the centre-right's candidate for the chancellorship in next year's general election.

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Norway's new government

No talk of joining the EU, right?

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Kjell Bondevik lays down his terms to his coalition partners

HE BEGAN a second term as Norway's prime minister on October 19th, and Kjell Magne Bondevik knows where he does not want to take the nation. He and his rural-based Christian People's Party say that the basis for his new centre-right coalition government will cease to exist if either of the other parties in it, the Conservatives or the Liberals, puts membership of the European Union on the agenda.

Where Mr Bondevik, an ordained minister in the Lutheran church, does wish to take his country is less clear. A friendly, decent man, and the most popular politician in Norway, he has a talent as a coalition builder, but he does not impress as a man of great political vision. His first administration is remembered for just two things: that it survived for 2½ years to February 2000, while controlling only 42 of the 165 seats in the Storting (parliament); and that Mr Bondevik took 3½ weeks off in late 1998 to be treated for depression.

He will need his survival skills again. His party has 22 seats in the Storting elected last month. The Conservatives have 38, but yielded the prime ministership when he said there would be no coalition unless he headed it. Their leader, Jan Petersen, has to be content with foreign affairs. With two Liberals, Mr Bondevik can count on only 62 votes, and the support offered by 26 members of the populist Progress Party is conditional: its leader, Carl I. Hagen, has said he will give the coalition 12 months to prove its worth. And Labour, though battered by the voters, with 43 seats is still the largest party.

Nor is policy exactly a guaranteed source of concord. The Conservatives want hefty tax cuts. Mr Bondevik's party wants to spend more on all manner of worthy causes, from schools, hospitals and the elderly to third-world aid. Since the public coffers are awash with revenues from offshore oil and gas, both parties will probably get what they want—unless, that is, the price of oil collapses.

The real test of policy may lie elsewhere. Even now, Norway's public sector controls about 35% of the country's industrial production, and dominates national savings through the state petroleum fund, which holds oil and gas revenues surplus to current requirements. Reforms of state ownership were promised in Tuesday's government policy declaration to the Storting. But what reforms, exactly?

One idea will come from the only unexpected new minister: Victor D. Norman, the country's leading academic economist and rector of its one significant business school, who became minister for labour and public administration. He recently co-wrote a book calling for reforms to reduce the power of the state. Further privatisation is unlikely, however. There may be some, but there is so little private-sector capital in Norway that selling giants, such as Statoil, the state oil company, would mean selling to foreigners. Professor Norman's recipe is to depoliticise state ownership by placing responsibility with foundations committed to managing state assets on a strictly commercial basis.

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The European Commission

Prodi's pique

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The head of the European Commission is losing his cool

THE strain of world events? The phases of the moon? Whatever the reason, Romano Prodi, head of the European Commission, is behaving increasingly oddly. At the end of last week's European Union summit in Ghent, he did not turn up for the closing press conference. An oversight? No: Mr Prodi's people went out of their way to make clear that it was a deliberate snub to Guy Verhofstadt, the Belgian prime minister and the summit's host.

Mr Verhofstadt's crime, it seemed, was that he talks too much: at previous joint appearances, he had not allowed Mr Prodi to get a word in edgeways. Belgian politicians' habit of saying everything twice, in French and then in Dutch, to ensure maximum television coverage, is indeed tedious. But then Mr Prodi is hardly famed for succinctness. His complaint made him look petulant and a bit absurd.

Picking a fight with the Belgians is in any case odd tactics: Belgium is traditionally a close ally of the commission, and Mr Verhofstadt used to be thought one of the few EU leaders with whom Mr Prodi got on reasonably well. For Mr Prodi has looked increasingly estranged from all the main national leaders—hardly a help for one who must try to forge political consensus. The British were once keen on him, but he rounded on them after they blocked moves towards tax harmonisation at last year's EU summit at Nice. He also clashed with the French at Nice, where Jacques Chirac seemed to go out of his way to humiliate him. Jose Maria Aznar, Spain's prime minister, is no admirer. Silvio Berlusconi, prime minister of Mr Prodi's native Italy, is an old and fierce adversary.

Till now, Mr Prodi's tactic had seemed to be an integrationist alliance with Germany and the smaller EU countries. He has avoided any open rift with Gerhard Schröder. But last week he offended not only Belgium but Germany too, letting it be known before the summit that he thought it “a shame” that Messrs Schröder, Chirac and Tony Blair planned to meet on their own before the full meeting began. Some lesser countries shared his disapproval. But, given that he could not stop the big three getting together, he seemed more insecure than impressive.

He may have chosen to hit at those he feels to be sidelining the commission. But when it was put to one of Mr Prodi's senior aides this week that perhaps the boss was off his rocker, the reply was: “You're not the first person to say that to me.”

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France's judicial system

The law's an ass

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Or is it just understaffed?

THE couple ran a coffee bar south of Paris. With two employees, they were shot dead on October 6th, for maybe FFr10,000 ($1,400). Ten days later, two policemen were shot dead in the Val de Marne, east of the capital. The suspected killer is one Jean-Claude Bonnal, known as “the Chinaman”, from his origins in Vietnam. He is under arrest. But why, ask the police and the minister of the interior, was he ever at large?

Mr Bonnal has, in his 49 years, accumulated prison sentences for 29. He has not served them. In 1998, he was arrested in connection with a department-store robbery in Paris that left ten people wounded. Last December, with no trial date set, a court set him free. The police cannot see why. Nor the minister, Daniel Vaillant. “He is a recidivist hold-up type convicted several times and today suspected of four murders, maybe more. He should have been in prison. Such things are incomprehensible. We must think what is needed to stop them.”

Trade unions representing the police and 6,700 magistrates want a toughening of the law, in force since the start of this year, that limits the time a suspect can be held without trial. Indeed, despite denials by the judge concerned, they say *le Chinois* was freed in anticipation of the new law coming into effect.

Yet should the law be weakened? In the past, a suspect's detention could be renewed on and on without limit. Even now, a murder suspect can be held, untried, for up to four years. Mr Bonnal could have been held for three in connection with the store robbery. A better answer surely would be to speed up the judicial process. As the unions argued while the law was before parliament, that would require more judges, especially the *juges d'instruction* who investigate crimes and remand suspects in custody. They get fewer cases than they used to, but last year that still meant 37,500. And how many of these magistrates are there? About 580.

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EU aid to Albania

Stinking fish

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The European Union's aid programme to Albania is a shambles

“THE EU'S capacity for making political promises is more impressive than our past record of delivering financial assistance,” said Chris Patten, the commissioner responsible for external aid, recently. Few parts of Europe need that aid more than Albania. The EU is its largest single donor. Yet an independent evaluation of EU aid to it over the past five years, undertaken at the behest of the European Commission itself, is fiercely critical of the programme's design and delivery.

At the root is an ill-conceived shift in strategy in 1999, to direct EU programmes away from general economic development and towards creating conditions for formal links between Albania and the EU. Those links, argues the report, will be pointless without first creating a solid economy and a robust democracy in Albania. Yet most of the aid programme has been bungled and has therefore proved largely ineffective.

Road-building projects have been “severely delayed by entirely foreseeable and indeed foreseen difficulties with land expropriation”. Water-supply schemes, vital in a land where water may be shut off for most of the day, are drowned in rows with the EU over financing mechanisms. In the report's nostrils, certain projects simply stink: it describes a plan to build fish markets as “incredibly botched up” and launched without any economic, financial or managerial analysis.

Why have things gone wrong? One reason is the European Commission's limited capacity and the time-consuming procedures it insists on. Mr Patten is trying to do better here, by reforming the management of aid programmes, increasing the staff and reducing red tape. But this is not the only trouble. Relations between the EU and its delegation in Albania have been poisonous: the report speaks of a “total breakdown of team-work” between them.

In the past, the delegation itself “directly contributed to financial and contractual irregularities,” says the report. It lists several examples, including “serious irregularities” in the payment of contractors building a border crossing to Greece. Under a new chief, the delegation is said now to be improving. And the commission “is taking very seriously all criticisms by independent consultants,” says a spokesman. Not before time: aid, maybe, but the EU has hardly given Albania much of a lesson in good government.

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Russia's Muslims

One faith, but not one vision

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The bombing of Afghanistan shows up divides among Russia's Muslims

CONDEMNING the attacks of September 11th was the easy bit for Russia's Muslim leaders. They have found it harder to strike a balance between endorsing the Kremlin's support for the American bombing of Afghanistan and soothing their own flocks' anxieties. Russia's two grandest muftis were silent at first, then condemned the bombing. The political leaders of Tatarstan and Bashkortostan, the autonomous republics with the biggest Muslim populations, remained in embarrassed silence.

Russia has plenty of citizens who are (at least culturally) Muslim: 20m, an eighth of the population, say Muslims; 14m, on official estimates. They are mostly the result of tsarist expansion within the past few centuries. Indeed, the Russians conquered cities such as Bokhara and Khiva only in 1869 and 1873; both are now in Uzbekistan but were under Russia's sway until 1991. Chechnya was conquered only in the second half of the 19th century, and resistance never totally died out. In the days of communism, the state tolerated Islam, as it did the Orthodox church, provided both stayed on the leash. And official atheism found no great echo among Muslims.

Most Russian Muslims live in the North Caucasus, or along the Volga river in Tatarstan and Bashkortostan. But there are many in the big cities such as Moscow, St Petersburg and Rostov-on-Don. Most are Sunni. Those in Tatarstan and Bashkorto-stan tend to be relatively modern-minded. But a strong mystical Sufi tradition endures in the North Caucasus. And since the fall of communism and the opening of Russia's borders, the more rigid Wahhabi variant of Islam, as in Saudi Arabia, has come in, notably in the North Caucasus.

In that impoverished region, the mainstream Muslim leaders, survivors usually from the Soviet era, have had little to offer people angered by their living conditions and seeking solace in their faith.

As in the days of communism, and because of them, most of these leaders are timid and ill educated. Few know much of their faith beyond the Koran; still fewer have an aptitude for theological discussion. Most stick firmly, as they did in Soviet times, to the notion of Islam as a spiritual affair, with few social or political obligations. Yet few of these men seem very spiritual. They quarrel a great deal among themselves, and many seem more interested in getting their share of the budget than in looking after their flock.

So Arab missionaries and younger and more eloquent Arab-educated mullahs have made rapid inroads in the past decade. They refuse to kow-tow to the politicians, they have lots of money, and they promise that the establishment of an Islamic state under *sharia* law would mean peace and prosperity. Not surprisingly, they did best in Chechnya, where radical Islam has so blended with the secessionist movement that the two are barely distinguishable. But an attempt to impose *sharia* law there failed completely, as the place sank into lawless chaos and under the weight of Russian troops. The missionaries also did well in next-door Dagestan.

To the Kremlin, Islamic fundamentalism and terrorism go hand in hand. The Russian forces' assault on Chechnya was triggered by an incursion of Islamist Chechens into Dagestan, and by a series of bomb

attacks that blew up several blocks of flats in Russia, not least in Moscow, killing some 300 people. The Kremlin says the bombers were trained in camps in Chechnya. Some attended a *madrassa* (religious school) known for its zealotry in the city of Naberezhnye Chelny in Tatarstan. The school has been closed, and Wahhabism banned in Tatarstan and Dagestan. In vain: the zealots have shaved off their beards, but they remain active in the shadows.

The old guard is conscious of losing its grip. Ravil Gainutdin, head of Russia's Council of Muftis, has asked the Kremlin to provide funds for home-grown Islamic education, to stem the influence of young, foreign-educated teachers. Some say this is just a ploy by Mr Gainutdin to puff up his own importance. But the muftis' embarrassment over Afghanistan reveals how torn they are between their old habit of keeping in with the Russian state and their newer desire, after decades of isolation, to identify with Muslims outside.

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Macedonia

That's the police station, that was

Oct 25th 2001 | SKOPJE
From The Economist print edition

An unknown bomber puts peace at risk

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OH, NO, not again? Yes, literally. The small police station in the northern Macedonian village of Tearce was one of the first targets of the separatist Albanian rebels of the National Liberation Army. The attack in January with anti-tank rockets and machineguns left several policemen wounded, one with an unexploded rocket stuck in his leg. It heralded eight months of violent insurgency. But by now that was supposed to be over. Arm-twisted by NATO, the European Union and the United States, the country's Slavic majority had agreed to give its 600,000 ethnic Albanians greater rights, not least in membership of the police. A peace accord to that effect was reached in August.

One of its main conditions was that villages like Tearce, sitting in the shadow of the mountains on the border with Kosovo and taken over by the rebels during the fighting, should be patrolled by ethnically mixed police units. So on October 22nd such a team of police deployed for the first time in Tearce and four other north-western villages, under the watchful and hopeful eye of officials from the EU and OSCE—the Organisation for Security and Co-operation in Europe—and of German troops sent by NATO to oversee the progress of peace. Hardly had the police patrol and the international caravanserai left the village than someone blew up Tearce's police station again.

No one was hurt this time, but plenty will be if the incident leads to fresh violence. Who did it? Local ethnic Albanians thought it too soon for Slav-Macedonian policemen, even with minority ones, to return. But would the rebels revert to violence just as the mixed policing that they want was starting? On their side, government officials have repeatedly called for displaced Slavs to be allowed to return to villages like Tearce formerly held by the rebels before Macedonia's parliament will ratify the constitutional changes. Given that they want these changes, would they quietly tell the army or police to do something that makes ratification unlikely? The best guess is that those responsible are people who want neither more rights for the minority nor peace.

That could mean the hardline Slav-nationalists and paramilitaries allied to the ruling VMRO party. The interior minister himself, Ljube Boskovski, is a hardliner. But there are also some breakaway rebels who would love to go on fighting.

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Charlemagne

Manuel Fraga

Oct 25th 2001
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He served Franco. But Galicia's newly re-elected regional premier has also served Spain

HE WAS a minister under Franco. Yet on October 21st he won re-election as premier of Galicia, Spain's north-western region, for his fourth term in a row. “No one chooses the period in which he lives or the circumstances in which he operates,” says Manuel Fraga, still, at 78, giving hints of the energy that often had him described as a volcano. “One only decides what one can try to do with them, and I tried more than most.”

He did. As minister for tourism and information in the mid-1960s, Mr Fraga set afoot the only serious attempt to reform the rigid Francoist state from within. He failed. But the attempt gave Spaniards a glimpse of the changes to come. “*Con Fraga hasta la braga”* (with Fraga down to the knickers) ran a catchphrase coined as he began to dismantle the censorship of films. Even those who suffered the clampdowns on dissent that went hand-in-hand with his attempts at reform acknowledge his relentless drive and his capacity for hard work.

Manuel Fraga Iribarne was born in 1922 in Villalba, a small Galician town, the eldest of 12 children. When he was three, his parents moved to Cuba, among 2m Galicians who emigrated in the 20th century. The family spent only a year there, but young Manuel did not forget: nearly 70 years later he struck up an unlikely friendship with Fidel Castro. Back home, with a little capital but much American-inspired enterprise, his father took to dealing in land and became mayor of Villalba. Pushed by their mother, a French-Basque teacher who instilled a belief in order and discipline in her brood, every one of the children went to university. But Manuel was the star. At Santiago de Compostela and Madrid he took degrees in law, politics and economics. He sailed through the competitive exams for high-level entry into government service, and, with professorships on the side, in time became one of the technocrats who ran Spain for the dictator in the 1960s. At a shooting party, he also managed to pepper Franco's daughter in the backside. He survived (so did she), but fell victim to the machinations of colleagues linked to Opus Dei, and in 1969 resigned. He went into business—and began to organise an “internal opposition”. He had contacts with the future King Juan Carlos, and with Jordi Pujol, later (and still) premier of Catalonia. He helped set up the newspaper *El Pais*. All were to be key elements in the democratic Spain for which he had argued in a book published in 1972, three years before Franco's death. As ambassador in London in 1973-75, he opened the embassy to Spaniards planning their country's rebirth.

Yet his own role was to be limited. The young new king chose a man nearer his own age as prime minister. Mr Fraga fought the first free elections, in 1977, at the head of a Francoist rump party, the People's Alliance, which—laboriously—he turned into a democratic party of the right, the parent of today's governing People's Party. In 1982, the Socialist Felipe Gonzalez won a solid victory, and in 1986 a second one. Mr Fraga announced his “definitive” retirement from politics.

It did not last long. In the drafting of Spain's new constitution, Mr Fraga had, unsuccessfully, resisted the recognition of “historic nationalities”—the Basques, Catalans and Galicians. But soon after quitting the national scene he was persuaded into Galicia's regional politics. Today, he argues for wide devolution, with the centre running only foreign affairs, defence and justice. The state, he says, “has become too small for some things, too big for others.” The initial rush in the 1950s to construct a federal Europe was doomed to fail, he thinks; the trend today throughout the European Union is towards devolution, and it will come. Like any other regional boss, he fights Madrid (and lobbies hard in Brussels) for infrastructure funds.

And Galicia has prospered. The dynamic Zara clothing and retail group is based there. The traditional pilgrimage to Santiago de Compostela today spins tourist money. Galicia, with its 2.8m people, remains poorer than other regions, but less so than it was. Yet its young people still leave for opportunities

elsewhere. The resultant disproportion of elderly, conservative voters aids Mr Fraga at election time. But, for all his espousal of Galicia's traditional sense of identity, its symbols and language (a kissing cousin of Portuguese), the young voters who remain have turned to the Galician Nationalist Block. Galician nationalism has less history and weight than that of Catalonia, and none of the Basque extremists' readiness for bloodshed. But Mr Fraga cannot ignore it: on Sunday, the nationalists took 23% of the vote in Spain (emigrants too can vote), far behind his party's 51%, but more than the Socialists, nationally the main opposition.

As “founder chairman” of the People's Party, Mr Fraga has retained influence in national politics. On the occasion when Jose Maria Aznar, Spain's current prime minister, won the party leadership, Mr Fraga argued for a woman candidate. “After all, she has good legs, and what use has a good head been to me?” the author of a biography, Anxel Vence, reports him as saying (quite credibly: Mr Fraga, now a widower living with his youngest daughter, is still happy to be politically incorrect). But the old centre-rightist and the younger one get on well enough.

I have done the state some service...

His critics say Mr Fraga's health is failing and that he should have retired gracefully. They accuse his administration of cronyism, and claim that he exercises ferocious control of the local media, recalling his old role as a censor. They also fear that his new administration will run into a mire of succession battles. Phooey, says Mr Fraga, waving a health certificate and promising more of the same, including a high-speed rail link for his region, further development of its ports and (implausibly) guaranteed jobs for its jobless young. Yet ask him to name his greatest achievement, and the regional politician quickly gives way to the national elder statesman: “Helping Spain find a means of survival after the civil war.” You could claim worse.

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Northern Ireland

Giving up the guns

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Reuters

The IRA's long-delayed decision to begin disarming breathes new life into the peace process in Northern Ireland

Get article background

THE IRA this week took a large step towards its own dissolution. Under the inspection of foreign observers, guns, rockets and explosives procured and stored to kill for a united Ireland were “put beyond use.” So said the Independent International Commission on Decommissioning, chaired by a former head of the Canadian armed forces, General John de Chastelain.

Northern Ireland's big moments have a habit of being undermined by fear and mutual mistrust between Protestant unionists and Catholic nationalists. This year 14 people have died violently in Northern Ireland, two almost certainly killed by the IRA, the other 12 by loyalist paramilitaries. The peace process, as Tony Blair admits, is not perfect. The decommissioning move, unlike the announcement of the IRA's 1994 ceasefire, brought no dancing in the streets. There were nonetheless signs that at last a barricade has been removed. The political climate might not encourage celebrations but no observer could miss a procession of firsts, developments that would have sounded incredible even months earlier.

A prompt response by the British government expressed the trust between Tony Blair and the republican leadership that has sustained an often-precarious joint enterprise. The form was an announcement that several army bases would be closed, including two watchtowers and listening posts along the border. Within 24 hours Mr Blair's Northern Ireland secretary, John Reid, was listing for the House of Commons a rolling programme of reforms to the criminal law system and policing which would now push on with “implementation” of the 1998 Good Friday Agreement. The sense of a carefully choreographed arrangement grew when President Bush and the American State Department chimed in with praise for a “historic breakthrough.”

This time, the sceptics were out of step

While the IRA move was generally recognised as a considerable contribution to peace making, it was predictably derided by some unionists. But the sceptical were this time out of step. The Ulster Unionist leader, David Trimble, immediately accepted the de Chastelain verdict as confirmation that decommissioning had begun, and moved to restore his party to the power-sharing Belfast executive, which would have collapsed if no IRA move had been made.

Contrary to appearances, most of the steps to put the process back on course were negotiated in July between all the main pro-agreement parties. The attacks in New York and Washington on September 11th and the embarrassment of the still unexplained presence in Colombia with FARC guerrillas of three republicans may well have accelerated the IRA's final move. But close observation of the republican leadership throughout the past few years suggests that the decision in principle to decommission came some years back.

In the end, the push came from Mr Trimble, and republicans' own desire to save the institutions set up by the agreement. The initial signs were that their belated move might indeed do that. First soundings suggested that Mr Trimble's positivism would produce adequate support inside his own party, in spite of predictably sour responses from the rival Democratic Unionists led by the Reverend Ian Paisley. Mr Paisley called the IRA move the result of a “dirty deal” with the Blair government. His deputy, Peter Robinson, dismissed the decommissioning announcement as failing to “scratch the surface.” He wanted an inventory of weaponry and proof of decommissioning. The two largest of the extreme Protestant loyalist paramilitary groups, the UDA and UVF, said bluntly that IRA movement made no difference to them, but their spokesmen sounded confused.

The loyalist paramilitary response, though depressing, might paradoxically help towards a positive outcome. Loyalist violence has been running at a comparatively high level over recent months, mainly in the form of pipe-bomb attacks on Catholic homes in bitterly divided North Belfast. Over 250 such attacks have been logged by police since the beginning of the year.

Unionist politicians, having always maintained that loyalist paramilitaries existed purely in reaction to the IRA, have begun to show some embarrassment and sense of responsibility for trying to improve relations. The sight of an almost anarchic paramilitary world, bathed in a harsh new light by the IRA development, may help Mr Trimble consolidate support for co-operation at the political level.

Even DUP scepticism has a useful dimension. An event witnessed only by foreign experts, with no list of material decommissioned, no photographic (let alone filmed) corroboration, requires a considerable act of faith in the International Commission. Mr Trimble led a delegation to question the commission before issuing his acknowledgment. DUP delegations routinely question the general and come out to scoff.

More significantly, although Mr Paisley huffs and puffs about terrorists in government, his party to date has followed the Ulster Unionists into the executive alongside Sinn Fein ministers, clinging to the subterfuge of not working collectively by boycotting full executive meetings. In the midst of their mockery of the decommissioning move, DUP spokesmen took care to leave open the possibility of returning to their two ministerial posts. As one said: “We will do whatever we have to do to represent our people.”

One of Mr Trimble's chief internal rivals, the UUP MP Jeffrey Donaldson, gave a less stringent demand than that from the DUP's Peter Robinson. He merely wanted to be told that this was “not a one-off” but the start of a process. That assurance seemed implicit in the de Chastelain statement, although as expected it was terse. The four paragraphs said that in accordance with a method agreed in August, the commission had now witnessed an event in which “the IRA has put a quantity of arms completely beyond use; the material in question includes arms, ammunition and explosives.” It also said contact would continue with IRA representatives. The sole comment was: “We are also satisfied that it would not further the process of putting all arms beyond use were we to provide further details of this event.”

Secrecy around method and material had long been predicted in speculation about the possibility of IRA decommissioning, given the dimension of the leap required. Gerry Adams and Martin McGuinness, the leaders of Sinn Fein, the IRA's political arm, were immediately denounced this week by former fellow gunmen for producing “the last sequence of surrender”, which would “delegitimise” what the IRA had done for 30 years.

In contrast, vox pops for radio and television on the streets of hardline republican districts produced a general welcome, with many people saying that disarmament was inevitable. Even so, others predicted it would never happen. The most sceptical of unionists ought perhaps to console themselves with the thought that in the end the IRA, against its own history, has opted for the political path. Northern Ireland's stumble towards peace has been too often interrupted to be confident that this week's move is a straight run forward towards peace. But there can be no doubt that it has erected a milestone, one that many thought they would never see.

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The anti-war movement

Phoney war

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The government is more nervous about the home front than it needs to be

THE martyrdom of Ken Livingstone, whose election as mayor of London the government tried but failed to prevent, should have convinced it that stifling dissent can sometimes be more damaging than accommodating it. Accordingly, ministers ought to regard such parliamentary opposition to the Afghan conflict as there is as an ornament of British democracy. But the treatment of one dissenting Labour MP suggests that the government hasn't yet learned this lesson.

Last week, Paul Marsden, a hitherto obscure backbencher who has criticised the government's military and constitutional handling of the war, was rebuked by Hilary Armstrong, the chief whip, who is responsible for discipline on the Labour benches. Mr Marsden was so incensed that he took the unusual step of releasing a transcript of their conversation, which he claims to remember verbatim. In Mr Marsden's account, he responds with principle and pith to Ms Armstrong's cack-handed attempts to coerce him into silence. His views on Osama bin Laden may be naive, and his behaviour verging on the treacherous, but Ms Armstrong guaranteed him some sympathy by allegedly declaring that “war is not a matter of conscience”, and likening doubters such as him to the appeasers of the 1930s.

EPA

Marching for peace

The chief whip, who is rarely a popular figure, has few friends on the Labour backbenches. Early in this parliament, she tried to rig the chairmanship of two select committees, which provoked a backbench revolt. She was also wrong to say that Mr Marsden had revealed his ignorance of parliamentary procedure by calling, as he had done, for a vote on the war: Tony Blair sought parliamentary approval for the use of force against Iraq in 1998. In fairness, though, that vote was unusual, and the government has given its critics ample parliamentary time to air their views. Nevertheless, as the prime minister's spokesman obliquely indicated, Ms Armstrong should not have been so dogmatic—because the government's majority is massive, and the number of dissenters is small.

Those isolationist Tories who criticised the Kosovo conflict have been silent. Charles Kennedy, the leader of the Liberal Democrats, has managed to sound cautious whilst remaining supportive. Robert Marshall-Andrews, a Labour MP who is critical of the bombing, estimates that between 60 and 100 of his colleagues share his apprehensions. But only a predictable handful—such as George Galloway, affectionately known as the member for Baghdad Central—have voiced them publicly.

The same situation obtains in the country at large. There has been one surprisingly well attended peace rally in London, where aggrieved Muslims, ordinary people worried about refugees, and anti-globalisation protesters swelled the peacenik ranks to upwards of 20,000. Smaller protests have occurred outside Downing Street and across the country. But the polls suggest overwhelming public approval for the

military action and Tony Blair's conduct. At the last count, around three-quarters of voters supported the war, and even more backed the prime minister.

Britons are often thought to be less sensitive to military casualties than Americans; but if the campaign is extended to include, say, Iraq, or there is a major terrorist attack in Britain, public opinion could shift. Dissent and unpopularity may also become problematic for the government if the conflict begins to have implications for domestic policy. Should the war conspire with the economic downturn to threaten the government's ambitions for public services, Tony Blair will face more than the current gaggle of dissenters. He may then regret the widespread resentment caused by Ms Armstrong's clumsiness.

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London Underground

Doing the splits

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Breaking up London's underground into three parts began as a political fudge. It could prove in the end every bit as expensive as fragmenting the railways

Get article background

LONDON UNDERGROUND'S latest campaign to convince its long-suffering users that there is light at the end of the tunnel is beginning to look ill advised. “Not for Sale at any Price...On Track for a Better Tube”, shout the station posters. Meanwhile, reports suggest that the giant construction companies involved in the government's public-private partnership (PPP) stand to make returns as high as 35%.

In the wake of the crisis of Britain's railways, the PPP plan for the underground is under intense scrutiny. The government this week announced plans for a new non-profit-making body to succeed Railtrack. But how London's crumbling tube should be run is still up for grabs.

The National Audit Office, which regards the government's case for the PPP as at best unproven, is considering whether to launch yet another inquiry. The parliamentary select committee for transport, which has dismissed the idea of franchising the infrastructure as “a convoluted compromise”, has also begun an investigation. Among other things, it will want to examine the prospect of those generous-sounding returns.

The essence of the PPP is for the infracos (short for infrastructure companies) to maintain and upgrade the tube's track, stations and tunnels in return for an annual payment, initially fixed for seven-and-a-half years. Against the wishes of London's elected mayor, Ken Livingstone, the government is planning shortly to sign contracts with two huge consortia led by Bechtel (Tubelines) and Balfour Beatty (Metronet). These will give the construction groups effective control of the tube's infrastructure for the next 30 years. Train operations will be the responsibility of Transport for London, a public body whose members are appointed by the mayor.

Ministers have repeatedly said they will not sign the PPP contracts unless they can be shown to represent value for taxpayers' money. Yet every independent examination of the plans has expressed grave reservations. The NAO said a year ago that the government had not properly considered the costs of breaking up the tube network. If anything the doubts have grown since then. A report by Deloitte and Touche said that London Underground's value-for-money argument for the PPP was based on “judgmental, volatile or statistically simplistic” adjustments. Robert Kiley, the New Yorker chosen by the mayor to run the tube, says that the government's sums simply do not add up. And that however inefficient public control is assumed to be, it could not fail to match what is being proposed. He claims that nearly half of the £13 billion pledged by the government for the tube would be swallowed up in

financing costs and returns to shareholders.

A confidential analysis, prepared for London Underground of the Metronet contract for the District, Circle and Metropolitan lines, gives a 35% internal rate of return on equity. By the standards of other “private finance initiative” projects, that is high, roughly triple the usual return. Metronet's financial director, Stephen Billingham, rejects the charge that the infracos are profiteering, pointing out that the equity in the PPP is a fraction of the amount of debt. The projected overall return to members of the consortia, he said, was not out of line with other private finance projects, roughly 15 to 20%. The performance targets by which the infracos will be paid, however, provide the opportunity for substantial profits.

In view of the political risks and the tendency of large construction projects to overrun their estimates, it would not be surprising if the tube consortia were demanding high rates of return. There are too many parallels with the ill-fated Railtrack enterprise. For a start, the PPP contracts are extremely complicated. At the last count, they span 135 separate documents running to more than 2,800 pages and nearly 2m words.

The grounds for dispute are legion. The incentive regime under which the tube will have to operate is dauntingly complex. The infracos will be paid according to performance criteria, ranging from punctuality and reliability to availability of services, judged against a baseline of the tube's operations prior to the PPP's introduction. Every delay to the tube of more than two minutes must be recorded and investigated, and responsibility assigned to London Underground, the infraco or some other party.

Disturbingly too, the PPP will also fragment what has been a single operation under unified management into a complex web of different private companies, with differing responsibilities and different interests. One of the painful lessons of the rail fiasco is that separating control of infrastructure from complex train operations is not a recipe for success.

The final irony is that the government has insisted on the PPP because it lost faith in the tube's management, London Underground. But who is now in charge of the day-to-day highly detailed negotiations with the infracos? None other than London Underground.

The PPP began life inauspiciously as a political compromise dreamt up by PricewaterhouseCoopers, an accountancy firm, to honour Labour's manifesto commitment to keep the underground in public ownership and to keep the peace between the deputy prime minister, John Prescott, and the chancellor Gordon Brown. It was hailed by Mr Prescott as “an entirely new approach, a third way.” Four years later, despite much tinkering, it still looks like expensive political fudge.

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Conservative Party

Six brains

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The Conservatives set off on a policy review but ideas are in short supply

THE new leader of the Conservative Party, Iain Duncan Smith, says he wants to make the Conservatives "the party of ideas". This came as something of a surprise to his supporters who had presumed that their new commander, a former Scots Guards officer, prided himself on his down-to-earth, common-sense approach to politics.

But the troops can rest easy, at least for the moment. There are no big ideas on offer, no dramatic changes in policy. What Mr Duncan Smith has done is to construct a new architecture of policymaking within the party as part of a policy review. This structure is unlikely to produce a ferment of new ideas, but it may help to re-connect the party with groups of key voters. And at this stage of the political process, after a second successive landslide election defeat, that may be more useful than straining to re-invent the wheel.

At the apex of the new structure will be a policy board, chaired by Mr Duncan Smith. Its six members include the party chairman, David Davis, the shadow foreign secretary and chancellor, Michael Ancram and Michael Howard respectively, Tim Collins, a Tory hard man, and David Willetts, nicknamed Two Brains for his brilliance and unconservative enthusiasm for ideas. The board will be supported by a new policy unit headed by Greg Clark, a former academic and special adviser to Conservative ministers.

Much like Tony Blair's policy unit in Downing Street, the new Conservative unit will attempt to develop long-term policies in key areas such as the reform of public services. It will, to an extent, take over that role from the Conservative Research Department, which has come to concentrate much more on the routine exchanges of political hostilities.

No policy review is complete without a new think-tank. Originally, the idea for one came from Francis Maude and Archie Norman, two disaffected supporters of Michael Portillo, the defeated leadership candidate. There was an obvious danger that this might have become a focus of opposition to the leadership. But the new, as yet unnamed think-tank, will not be the kind of free-ranging, subversive, one-madman-in-a-basement outfit beloved of the early Thatcherites in the 1970s. Mr Duncan Smith will be the chairman of the new entity, and established party figures such as Mr Willetts will guide its course.

This system of policy-making plays safe, keeping everything well within the boundaries of the official party structure. There will be no thinking of the unthinkable. It reflects the view that politics has moved into an era of pragmatism. On this reading, the political party that wins elections now is not the party that can set off the most ideological fireworks, as with Thatcherism in the 1980s. It is the party that comes up with the most detailed, thoroughly researched and workable policies for areas like the reform of public services or London Underground. This is now the (rather more mundane) Holy Grail.

The new policy structure will try to involve groups of people that the party knows that it has lost touch with. Take the new think-tank. This will draw largely on the work of the younger generation of Tories, those under 40 who are councillors or aspiring MPs. Some have just contributed to "A Blue Tomorrow", a book of essays on how to re-shape the party. One author argues that the party is in "cultural denial", and most of the essays explore ways in which Toryism can be more successfully applied to modern society.

One of the editors of the book, Nicholas Boles, argues that the virtue of people like himself is precisely that they are not professional politicians. They can bring their experience of the real world to bear on Conservative politics, away from the Westminster village: "What we can't afford to do anymore is to develop ideas in a political bubble." Mr Boles argues that shadow ministers should also have "shadow advisory groups" drawn from professionals in their specific areas.

But probably the most intriguing part of the policy review is the European dimension. Shadow ministers will be travelling to France, Germany and the Netherlands to discover why continentals can get their trains to run on time and provide hip operations within days instead of years. The results should enable the Conservatives to take a more critical look at the government's record on public services. It might also at the same time help to divest the party of the xenophobic image that it has picked up over the last few years. That might make its opposition to the euro more appealing, especially to the young.

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Mobile phones and crime

Crime waves

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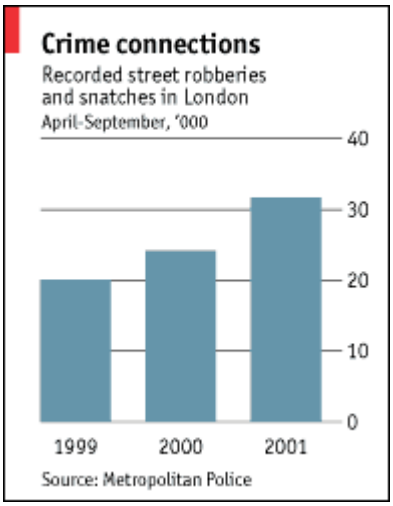
Mobile phones are bad for crime figures

AS MANY a jealous lover has discovered, mobile phones are a useful tool for adulterers. But they also have attractions for more serious offenders. Mobile phones are changing the ecology of crime, to the alarm of police and politicians.

The most obvious criminal implication of mobile phones is that an awful lot of them get stolen. Figures released last week by the Metropolitan Police revealed that there was a 31.4% increase in street robberies and snatch thefts in the first six months of this year (see chart). Half of all those offences involved a mobile phone, and in two-thirds of those, the phone was the only thing stolen. Such phone robberies in London have quadrupled in two years. The national picture is similar: overall crime is falling, but robbery and theft from the person are rocketing, driven in part by the fad for pinching phones.



The Home Office is understandably worried about this boom, and has got together with the police and the industry to try to solve it. A technique used by Dutch police known as “SMS bombing”, whereby a relentless barrage of reproachful messages is sent to stolen handsets, is not viable in Britain. Accounts registered to stolen phones can be barred, but the handsets themselves may still be valuable. John Cross, head of security at BT Cellnet, says the industry is hoping to develop a way to put stolen phones out of action. Even that might not solve the problem, since many phones are stolen by teenagers and then simply thrown away.

But the threat posed by mobile phone technology is graver even than the potential frustration of the government's pledges on crime. The National Criminal Intelligence Service has highlighted the use of mobile phones in organised crime. Pay-as-you-go phones, in particular, have the obvious advantage to criminals of being untraceable.

On the other hand, phone data can be used to establish the whereabouts of suspects. At the moment the results are only approximate, but they will be much less so when third generation mobile phones arrive. Libertarians worry that this technology, and newly acquired government surveillance powers, could compromise civil liberties.“You might as well be carrying a tracking device”, says Caspar Bowden, of the Foundation for Information Policy Research. But whilst gathering such data might be intrusive, it is unlikely to be of much use in court. The men suspected of the Omagh bombing rebuffed mobile phone evidence, claiming that their phones had been lost or borrowed.

Likewise, the spontaneous acts of citizenship that mobile phones facilitate can do as much harm as good. Jock Young, a criminologist at Middlesex University, says that like the invention of the telephone, the advent of mobiles has enabled people to report some crimes when previously they wouldn't have considered it worthwhile. They can be used to summon help from remote locations. But they also have the capacity, says Barry Irving of the Police Foundation, a think-tank, to emasculate the emergency system, because of too many people witnessing the same event and reaching for their phones. Every new technology creates winners and losers. In the case of mobile phones, it's the police who appear to be losing.

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Devolution

Healthy outcome

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Scottish health-care reforms are a headache for English ministers who have less money to spend on their voters

DEVOLUTION has its problems. Before elected regional assemblies arrived in 1999, limited autonomy allowed the Scottish, Welsh and Northern Irish health services to develop slightly differently from England's NHS. Now the assemblies are starting to push the health systems in each part of Britain further apart. Allowing different policies in different bits of Britain was always the aim of devolution. But change in one part, particularly Scotland, can force reform elsewhere. This could turn out to be a headache for Tony Blair.

Some changes are small but interesting experiments: whether, for example, a Welsh decision to make free eye tests widely available will cut the incidence of serious eye disease. Others, such as local health management structures in Wales and regional structures in Scotland, can test which system produces the best results.

But other changes present bigger problems. An example is the decision by Henry McLeish, the Scottish government's first minister, to pay for the personal (as well as medical and nursing) care costs, of old people. This idea of paying for help needed with bathing and eating, urged by a royal commission, was rejected by Tony Blair. He felt that taxpayers' money should not go to wealthier old people who could afford to pay their own care costs.

Mr McLeish, however, felt that if it was right to pay for the care costs of cancer patients, it was right to pay the same to people suffering from congenital conditions such as Alzheimer's. His scheme is less of a handout than English ministers at first feared. Old people in care homes can get £65 a week for nursing care costs and up to £90 a week for personal care costs. Pensioners living in English care homes can get much the same through the nursing care (up to £110) and attendance allowance (up to £55), a social security payment which Scottish recipients of personal care allowances will no longer get.

Nevertheless, a demarcation of principle on this issue has been laid down between Scotland and England. The Scots are aiming to maintain the old NHS principle of providing a service free at the point of delivery regardless of wealth, whereas the English service is only free, or at least subsidised, for poorer people.

The Scots can afford this because Scotland gets from the Treasury about 22% more money per head than England does for the health service. The extra money was originally agreed because the Scottish health record is poor: measured by mortality indices, people north of the border are about 17% less healthy than the British average. So the Scots can afford to employ more doctors and have more hospital beds, resulting in shorter waiting lists, than the rest of Britain (see table).

Lucky Scots
1999-2000

	England	Scotland	Wales	Northern Ireland
Spending per person on health*, £	1,041	1,271	1,180	1,193
Average daily NHS beds available per 1,000 population	3.7	6.8	5.0	5.1
% of population on hospital waiting lists for 12 months or more	4.2	1.3	13.8	21.8
Doctors per 1,000 population	5.6	7.3	6.0	6.6

Source: Public Expenditure Statistical Analysis, 2001 edition *Includes personal social services

This sets a challenge for Mr Blair. As he pushes English NHS spending up towards Scottish levels, will he be forced to emulate the Scots on personal care costs? The question is not academic: a year after the Scots reintroduced student grants and abolished student tuition fees in favour of a form of graduate tax, Estelle Morris, the education minister, announced she was going down the same route for other British students.

But Mr Blair also has a challenge for Scotland and Wales. His plan for a better NHS involves making more use of private medicine by, for example, using private hospitals for NHS-purchased operations. Scottish and Welsh ministers, however, have turned up their noses at this strategy. They say that their countries' private medical provision is much smaller than England's and they want to keep it that way.

Of course, the Scots and the Welsh might follow the English example. But if they don't, will English taxpayers be happy to carry on contributing so that the Scots and Welsh can carry on with old-style publicly funded health services?

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Bagehot

David Blunkett

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An authoritarian inhales

EVEN his Conservative opponents will admit over a good enough lunch that David Blunkett is a formidable politician. Indeed, David Willetts, his Tory opposite when Mr Blunkett was still in charge of education, remembers feeling confident only once that one of his parliamentary assaults on Mr Blunkett was striking home. For reasons that Mr Willetts could not quite fathom at the time, a speech he was making in the Commons began to cause visible consternation not only to Mr Blunkett himself but also to the whole Labour front bench. Encouraged, Mr Willetts yammered on. Only when he was half-way through his peroration did he receive a chastening handscribbled note. The consternation opposite had been caused not by Mr Willetts's debating shafts but by the fact that Mr Blunkett's guide dog had just been sick on the Commons floor.

The guide dog—or, at least, what the guide dog represents—is of course part of what makes Mr Blunkett formidable. Nobody who has been blind for most of his life, and bone-poor for all of his childhood, rises to the cabinet unless he has something special about him. But this is far from being Mr Blunkett's chief advantage in politics. His chief advantage arises from his having been a hero of municipal socialism when he was leader of Sheffield City Council during the Thatcher years, and now being a completely sincere adherent of New Labour. In the Labour Party, this bridging of traditions gives him a moral authority that lesser cabinet ministers can only aspire to. By the time of the general election last June, the drive, the legend, the moral authority, the imminence of a book of great political thoughts and his elevation from education secretary to home secretary had conspired to set off speculation that he and not Gordon Brown might in the end inherit the leadership from Tony Blair.

Four months on, how is Mr Blunkett faring? The book of great political thoughts is, frankly, a bit of a bore. “Politics and Progress: Renewing Democracy and Civil Society” (Politico's, £8.99) will not propel the home secretary into the bestsellers' list with its calls for rebuilding democratic dialogue, lifelong learning, an active welfare state, a stronger sense of citizenship and other familiar ideas. On the other hand, being home secretary, especially after the terrorist attacks of September 11th launched a thousand editorial columns on the proper trade-off between public safety and civil liberties, has propelled Mr Blunkett even further up the news agenda than he was as education secretary. This, of course, is both a danger and an opportunity.

The Home Office is famous for tripping up even the most agile politicians. For Mr Blunkett it held an extra danger. His reputation as a social authoritarian primed critics on Labour's left to expect a home secretary who would be “even more right-wing” than Jack Straw, the man he replaced.

One of the first things Mr Blunkett did at the Home Office was to sack Keith Hellawell, the drugs “tsar”. Mr Blunkett recognised that the drugs policy was going nowhere. Despite having some of the toughest anti-drugs laws in the developed world, Britain also has one of Europe's worst addiction records. This week, Mr Blunkett announced his intention to reclassify cannabis from a class B drug to class C, putting it in the same category as anti-depressants and steroids. Technically, cannabis will remain illegal, but people will no longer be prosecuted for possessing it. The use of cannabis for medical purposes will be legalised, after more research. The government may also consider reclassifying other drugs, such as ecstasy.

This is a sensible change on the margins of drug policy rather than a radical move towards decriminalisation. But even this had been rejected by Mr Straw for “sending out all the wrong signals” when it was recommended last year by the Police Foundation, a rather superior committee of the great and good. Mr Blunkett's U-turn might of course suggest a simple difference of policy opinion: he was influenced largely by the disproportionate amount of police time wasted in cannabis-related arrests. But

it also suggests that this supposed social authoritarian is less wary than Mr Straw was of exposing himself to the charge of being a liberal, and more able to persuade Mr Blair to change direction. It also fits in well, his friends say, with his general political philosophy. Shocked by the low voter turnout in June's election, he has been arguing that politicians lose respect when they pass or retain unenforceable laws.

Twin towers

So far, so admirable. September 11th, on the other hand, poses more delicate challenges. A home secretary who does too little to rebalance civil liberty and public safety looks complacent. One who does too much looks authoritarian. Just before going to the Labour Party conference last month, Mr Blunkett wrote an article in the *Guardian* promising to approach this balancing act “with care”. Quoting his new book, he stressed the need to secure democracy by “reinvigorating democratic engagement” and revitalising “wider civil society” so that individuals can truly be “active citizens”. Freedom, he asserted, does not just mean doing what you want without harming others. “It means engaging in the wider collective endeavour of shaping our society.”

Well, maybe. But after the twin towers, it is not “positive” liberty—active citizenship, more voting and all that—that is at risk. It is that old-fangled right to do what you want if it does not hurt others that Mr Blunkett needs to weigh against the demands of public safety. Instead, he proposes to make it easier to detain suspects without charge, to suspend parts of Mr Straw's Human Rights Act, to introduce a retrospective law to penalise anthrax hoaxers, and to frame a law to ban the incitement of religious hatred. Exceptional times do of course demand exceptional measures. But it is hard to escape the conclusion that when municipal socialism meets New Labour, liberty is not prized as it should be. Perhaps that book of his deserves closer scrutiny.

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Limping towards normality

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Poland may be one of Central Europe's most successful reformers, but its new government has plenty left to do, says Matthew Valencia

AP

OUTSIDE Solidarity's headquarters in the centre of Gdansk, a short distance from the world's most famous shipyard, some 40 flags bearing the trade union's emblem flap proudly in the breeze. Inside, the lobby kiosk still does a reasonable trade in Solidarity clocks, T-shirts and computer mouse pads. But the mood of the building's occupants is sombre these days. Twenty years ago the heroic workers of the Lenin Shipyard, led by Lech Walesa (who later became president), were at the forefront of the fight against communism. Now the movement they created is in the political wilderness.

In last month's general election, the Solidarity-based coalition that had run Poland since 1997 was trounced by the Democratic Left Alliance (SLD), the reformed communist party, led by Leszek Miller (pictured above). The centre-right Solidarity grouping, known as Solidarity Electoral Action (AWS), went straight from governing the country to having no seats at all in the *Sejm* (lower house of parliament), having fallen below the 8% threshold needed for party alliances to be represented. Voters, it seems, thought the organisation that once led them out of political captivity had taken them down an economic cul-de-sac.

And yet there is much to celebrate in Poland's past decade or so. When communism collapsed, the economy veered out of control, but was quickly stabilised by a dose of “shock therapy”—a form of brutal economic engineering that the Poles pioneered. Throughout the 1990s, Poland managed to avoid the recessions and currency crises that afflicted Central European neighbours such as Hungary and the Czech Republic. Even better, for much of the decade it grew faster than other countries in the region, acquiring a reputation as an “eagle” economy: in the second half of the 1990s it notched up an average growth rate of 5.5% a year. Just as important for a country that saw prices gallop out of control twice in the 20th century, it brought down inflation steadily and has now reduced it to single digits.

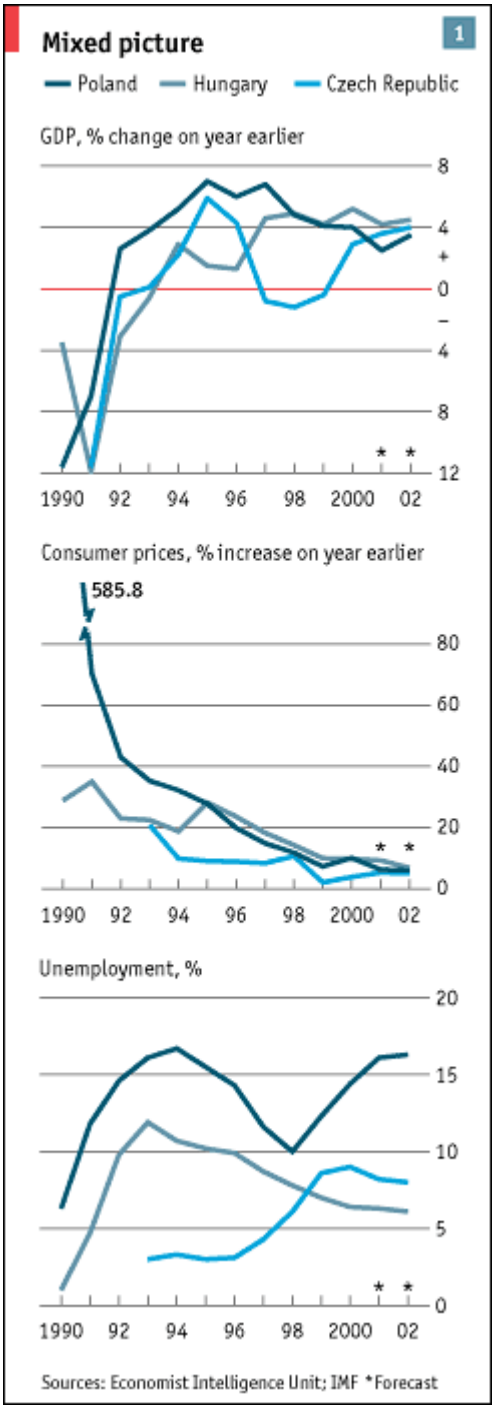
Underpinning this transformation was an entrepreneurial spirit that even communism had never been able to stamp out completely. Even back in the moribund 1980s, the private sector kept a toehold, accounting for 5-10% of economic activity. Today the country has 2m registered businesses, one for every 19 Poles. Foreigners showed their appreciation of Polish enterprise by putting a record $13 billion of direct investment into the country last year. Thanks to the money and expertise they bring, and the restructuring they insist on, manufacturing productivity in Poland has recently been growing at around 10% a year.

At the same time the country has reoriented itself westwards. It was admitted to NATO in 1999 and is fervently hoping to join the European Union in 2004. For the EU, and more particularly for Germany, Poland is the first-wave applicant that really matters—and not only because its population is bigger than those of all the other front-runners (Cyprus, the Czech Republic, Estonia, Hungary, Malta and Slovenia) combined. Western Europe feels a sense of moral obligation towards Poland: after centuries in the cockpit of European conflict, the country cannot be left in the lurch again. And the Catholic Poles, despite their geographical position in the east, have always felt culturally western, anxious to “return to Europe”. In economic terms, this journey is well under way: a country that 12 years ago was a faithful member of the eastern block's Comecon

trading system now sells two-thirds of its exports to members of the EU.

There are other ways in which Poland is becoming a more “normal” country. Its peculiar brand of democracy is maturing. Its political life, though at times still unruly, is gradually becoming more ordered and less polarised by old ideology. The SLD has made genuine efforts to modernise itself. Even its enemies on the right mostly admit that it can no longer be described as a bunch of apparatchiks; the outgoing Solidarity government even managed a successful cohabitation with a president, Aleksander Kwasniewski, who was once a communist minister of sport.

Another sign of normality is a greater willingness to confront the past—witness the recent debate over a massacre of Jews in 1941 at Jedwabne, a small Polish town. Poles used to blame the killings on Nazis, but recent historical studies have shown that they were carried out by Catholic townsfolk. Mr Kwasniewski visited Jedwabne in July and made a contrite speech. Apart from a few on the religious right, Poles now accept that it was a dark moment in their country's history.



Good old days?

Despite these signs of progress, however, Poles are pessimistic about the future. When President George Bush stopped off in Warsaw in June and praised their achievements, many thought he must have been wearing rose-tinted spectacles. There is growing ambivalence towards the market and suspicion about joining the EU. For all the talk about catching up quickly, Poland's nominal GDP per head is still less than a quarter of the West European average. Nostalgia is growing for the certainty of lifetime employment that communism used to offer. Tellingly, around 10,000 people attended the recent funeral of Edward Gierek, a leader of the communist era who put a smattering of western goods into Polish homes in the 1970s. Nobody cared to remember that to achieve this light relief, he drowned Poland in foreign debt.

Behind the nostalgia lies growing inequality. Poland is fast becoming two nations: one of comfortably-off city dwellers and one of dirt-poor villagers, many of them working on the 2m family farms. Another gap is opening between the west of the country, which enjoys close ties with Germany, and the east, abutting dilapidated Ukraine and penniless Belarus (see map). As inequality grows, so does crime: surveys suggest that most Poles no longer consider their country a safe place. When asked if Poland is going in the right direction, three-quarters of them say no (though few would advocate a return to central planning).

So what is new? The Poles are among Central Europe's most inherently pessimistic people. “To admit that life is good is seen in some circles as almost indecent,” says Andrzej Wiszniewski, the last government's science minister. “The only thing we don't grumble about is our children.” All the same, the current wave of disgruntlement has some clear and specific causes. Most important, Poland's eagle-economy credentials are looking increasingly dubious.

Economic growth last year slowed to 4%, and this year is likely to fall below 2%—the worst result since Poland emerged from shock therapy a decade ago. Cyclical factors—some external, some domestic—are partly to blame. Poland has suffered from the slowdown in both America and Europe, particularly in Germany, which takes a third of its exports. Russia's financial meltdown in 1998 also did a lot of damage. According to Rafal Antczak of the Centre for Social and Economic Research in Warsaw, it knocked a full percentage point off Polish growth in the years since.

Equally important, Poles are spending less than they did during the credit-fuelled consumption boom of the late 1990s. Consumer confidence has fallen fast: in the first half of this year, car sales were 30% below last year's level. And companies are reluctant to invest as long as Poland's hawkish central bank keeps interest rates high.

Two years ago, a yawning current-account deficit threatened the zloty's stability. The gap has since been reduced to safe levels, but another huge hole has opened up, this time in the national budget. Finance-ministry officials worry that this could delay Poland's EU accession. If nothing is done, the deficit will reach 11% of GDP next year. That would be difficult to finance “without becoming another Argentina”, says Krzysztof Rybinski, chief economist of Bank Zachodni WBK.

How did the public purse get so tattered? Predictably, the outgoing AWS government blames the left-wing administration of 1993-97, whereas the socialists insist that the trouble started after they went into opposition. In truth, both sides deserve some blame. Big chunks of the welfare system remain much the same as in communist times, with benefits spread thick and wide. Poland's social-security contributions are proportionately among the highest in Europe, as is the number of people on disability benefits (many of whom are cheating). The most recent parliament added recklessly to spending.

This has led to an awkward stand-off with the central bank, whose governor, Leszek Balcerowicz, was the father of shock therapy when he was finance minister in 1990. Mr Balcerowicz and his colleagues at the bank say interest rates will have to stay high (the key rate is well over double the rate of inflation) until the politicians can demonstrate fiscally responsible behaviour. Ministers complain that the central bank is strangling growth. But the current slowdown, says Mr Balcerowicz, has its uses: “You could say that the earlier growth came at the cost of growing imbalances.” In other words, Poland's proud eagle tag was only partly deserved.

Reforms, round two

Even if the new government can tame the public finances, however, it has some daunting longer-term problems to contend with. Although the Solidarity government began to tackle health care, education, pensions and public administration, with mixed success, it merely tinkered at the edges of the state-owned industries and the labour market.

The biggest challenge now facing the government is unemployment, which has climbed from 10% of the workforce in 1998 to 16% now. It continues to grow, especially among the young, and is expected to pass the 20% mark next year. In some depressed areas it has already risen well above that.

The labour market is under pressure from two sides. As firms try to boost productivity in the face of slowing growth, and job-protection clauses in privatisation contracts expire, workers are laid off. At the same time many more jobseekers are beginning to pour on to the market. During martial law in the early 1980s, Poland's cowed workers took to their beds (what else was there to do?) and reproduced as never before. The baby boomers they conceived are now starting to look for work: over the next five years, Poland's labour force will see a net addition of 1m workers.

The resulting high unemployment will take some fixing. Analysts think the economy will have to grow by 5% a year for joblessness to fall; some draw a parallel with Spain, where a successful economy did not prevent unemployment from staying stubbornly above 20% for much of the 1990s. The countries to Poland's west worry that its unemployed will flood their labour markets, access to which is a key negotiating point in EU entry talks. Mr Kwasniewski admitted recently that Poland's high unemployment problem gives the EU a “strong argument” for closing its doors to eastern workers.

So the new government is taking over at an unenviable time. It will have to preside over some belt-tightening, but it will also have to create new jobs. And it must bring in an array of other reforms to prepare for EU membership, against opposition from Poland's anti-reform trinity: the church, the unions and the farmers. Their conservative influence may have waned since 1990—the SLD may soon be able to relax strict anti-abortion laws, for instance—but it is not negligible. Agrarian and church-backed protest parties did surprisingly well in the recent election, winning almost a fifth of the vote between them. And although unions have seen membership fall (tellingly, they no longer publish figures), they still have many friends on both sides of the *Sejm*.

This survey will argue that despite these challenges, there are many grounds for optimism. Poland may yet regain its position as Central Europe's most dynamic economy. Its politics are messy but vibrant. Its path to membership of the EU may be rocky, but it is clearly marked. Large parts of the old system have been thoroughly modernised, including education and pension provision. As for those parts of the reform agenda that are unfinished or untouched, the new left-leaning government has every reason to act quickly—and if some of its actions prove painful, it can always blame the bureaucrats in Brussels.

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Loss of solidarity

Oct 25th 2001
From The Economist print edition

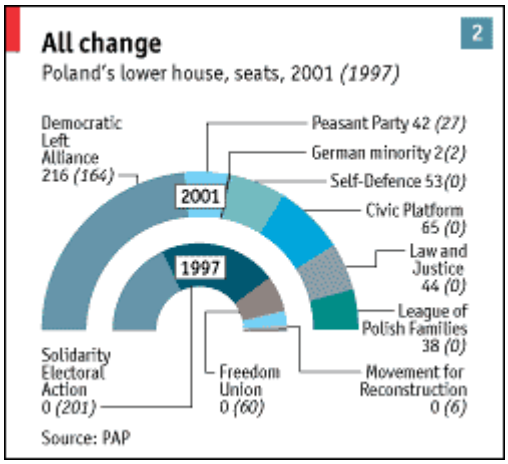
The left is up, the right is down. But what does it all add up to?

DON'T be fooled by the past half-century: Poland has a long and colourful history of democratic rule. In the 16th century, when the country was in a union with Lithuania, its kings were, in effect, hired under contract and reported to an assembly of regional leaders, rather like a modern chief executive answers to his board. In the 17th century, the assembly adopted the principle of *liberum veto*, which gave individual members the right to reject legislation. It may have been admirably fair, but caused many deadlocks.

The past decade has seen the return of a tumultuous sort of democracy. The pendulum of power has swung between right and left in a succession of unstable coalition and minority governments, led by nine prime ministers, one of whom served twice. The number of parties chasing seats may have fallen from the roughly 100 that contested the 1991 election (including a Beer Lovers' Party), but breakaways and new groupings still emerge frequently. The old saying remains true: take two Poles and you have three political parties.

Yet one of Poland's greatest triumphs of the 1990s was that, despite its political gyrations, its policies remained steady. None of its governments completely turned its back on privatisation, deregulation or membership of the European Union. Indeed, some parts of the political spectrum are jointly inhabited by both right and left: both sides have close links with the unions and both preach social justice, for instance.

That common ground may help to explain why so many former Solidarity supporters were prepared to switch to the SLD in last month's election—though not quite enough to give the party a majority on its own (see chart 2): it has had to form a coalition with the agrarian Peasant Party. By and large, the SLD has appeared united behind Mr Miller, the new prime minister. Its leaders are seen as competent. Many voters look back fondly on the former communists' stint in government in 1993-97 (also in coalition with the Peasant Party): the economy was booming then, and the shops were full of fancy goods. Few understand—or care—that the failure to undertake reforms at the time stored up trouble.



Poles' craving for unity and competence is understandable. In its last year in office, the ramshackle Solidarity-linked coalition, AWS, offered nothing of the sort. Things began to go wrong last year when the Freedom Union, the most liberal group within the government, walked out, leaving AWS to run a minority government. That prompted many of AWS's pragmatists to defect to new right and centrist parties, leaving behind mainly unionists, nationalists and hardline Catholics who are leery of modernisation. A wave of cabinet infighting led to the sacking of the finance, justice and communications ministers in the run-up to the election.

Can the right rebuild itself? Some argue that Solidarity was never comfortable with the leap from the shipyards to the *Sejm*, and has simply outlived its usefulness as a political force. Now that it has lost many of its brighter people, it lacks an intellectual core. What it does have, though, is an infrastructure—regional offices, activists and so on—bettered only by the SLD's and the Peasant Party's, says Jacek Kucharczyk of the Institute of Public Affairs in Warsaw. Solidarity formed a right-of-centre block with three other parties for the recent election to the Senate, the upper house. For now, though, talk of a revival is premature. Solidarity is even considering a retreat to becoming a plain trade union once more.

The party that has emerged as the main opposition did not exist a year ago. Backed by a slick marketing campaign, Civic Platform, known as Platforma, won an impressive 13% in its first election. It is a centrist

grouping of pro-business liberals drawn from the upper ranks of AWS, the Freedom Union and the SLD. Its patriarch is Andrzej Olechowski, an independent ex-minister and banker who trailed Mr Kwasniewski in the most recent presidential race.

Platforma bills itself as a modern party that will elect all of its candidates in primaries. Some see it as merely a jazzier version of the Freedom Union: even Mr Olechowski describes it as a “better shop on the same street” as the Freedomites. Its programme has four main planks: lowering the cost of doing business, fighting corruption, introducing direct elections for officials and promoting the Internet, which at present only 5-10% of Poles use regularly.

This goes down well with the fast-growing population of young, middle-class urbanites who have flocked to the party. Platforma's bosses have understood that a new generation of voters wants a new generation of politicians. Chief among its youngsters is Pawel Piskorski, the telegenic 33-year-old mayor of Warsaw. His enemies dismiss him as a political chameleon who puts style over substance, but few doubt that he will do a better job of drawing in the young voters than the grey-haired lot who run the sputtering Freedom Union.

Platforma has weaknesses as well as strengths, however. So far, its group of strong-willed leaders has presented a united front, but infighting might start as the party fleshes out its manifesto. And there are some glaring policy gaps. For example, the party has little to say about rising crime—unlike some other new parties, such as Law and Justice, set up by a former justice minister and his twin brother.

Miller's tale

The new government's main challenge, though, will not be catching criminals but fixing the economy. One way or another, the budget will have to be brought under control. Mr Miller balks at the idea of cutting social-security benefits, arguing that this would reduce demand and drag down growth even further. Instead, he wants to narrow the gap by streamlining the state. Poland is awash with state agencies that are funded by the budget but outside the control of parliament. Most of these are profligate and overmanned. Up to 30 are expected to be closed or made to merge. “The government has to send a strong signal by starting with itself,” Mr Miller says.

At the SLD's heart is a group of liberals who understand the need for austerity; they even managed to persuade the party to vote against a rise in teachers' salaries just before the election. The new finance minister, Marek Belka, accepts that the cuts he will have to make could lead to mass protests. They may upset chunks of the SLD too. But then the party's pre-election unity was deceptive: as within Solidarity, its liberals often clash with its bigger interventionist wing.

Individual members of the SLD have already sent out some worrying signals. Just before the election, Wieslaw Kaczmarek, the new treasury minister, suggested rolling back pension reform by withholding money earmarked for private pension funds. Some in the new coalition would also like to make the central bank less independent, and senior figures have even suggested refixing the zloty, which was floated in April 2000. Economists fear the SLD will be tempted to go for growth at the expense of stability.

Mr Miller is working hard to dispel such worries. Once a member of Poland's last communist politburo, he has recast himself as a Europhile social democrat, saying that “a party moving to the centre is a party moving forward.” He also claims to favour cutting taxes on business and making it easier to hire and fire. But Mr Miller's real programme, suggests Mr Olechowski, can be summed up in four words: support, assistance, subsidies and guarantees.

A question mark also hangs over the prime minister's relationship with Mr Kwasniewski, who helped to found the SLD but has stood above domestic politics since becoming president in 1995. The two get on well, but their unity may not last. Mr Kwasniewski has hinted that Mr Miller should concentrate on what he knows best—domestic politics—leaving the president to take the lead at international get-togethers. Should the two fall out over this division of labour, Mr Kwasniewski could make life difficult: the president has the power of veto over new legislation.

Keep it clean

Mr Miller would be wise to avoid a row with his president. Solidarity's heavy election defeat is largely explained by its infighting. Poles are clearly tired of party squabbles, and surveys suggest they now also associate political bickering with corruption.

Indeed, tackling corruption should be a priority for the new government. Polish voters are convinced that their elected officials are more venal now than they were in the idealistic early 1990s. That is hard to prove, but a recent rash of scandals seems to lend support to the argument. “Our politicians constantly embarrass us,” laments Wanda Rapaczynska, chief executive of Agora, which owns Poland's best-selling daily newspaper, *Gazeta Wyborcza*. No surprise, then, that a group of Warsaw students, when asked by *The Economist* to name their political role models, mentioned Ronald Reagan, Harry Truman and Wladyslaw Sikorski, Poland's wartime leader-in-exile, but no living Pole.

Some progress has already been made. Poland was one of the first countries in Central Europe to pass an anti-corruption law. Last year party finance was made more transparent to deal with concerns about lobby groups that had provided anonymous party funding. And in August a law was passed that obliges politicians in both the *Sejm* and the Senate to declare their personal assets and open them to scrutiny by state auditors.

This may not be enough to keep deputies in check, reckons Grazyna Kopinska, who runs the anti-corruption programme at the Stefan Batory Foundation, a think-tank. She also feels that Poland needs a better law on conflicts of interest. At the moment, politicians and officials can take up private-sector jobs in their former areas of interest within a year of leaving office. One Polish tycoon, Aleksander Gudzowaty, has hired at least eight former top ministry officials. Relations between politics and business remain “thoroughly opaque”, says Ms Kopinska.

Platforma argues that Poland should follow the Swiss example by outlawing the taking rather than the giving of bribes. That might make it easier to persuade bribe-givers to testify against bent politicians. As one Platforma leader recently pointed out, most of the cars parked outside the parliament building are too flash to have have been bought with honest money. But many Poles think that corruption in their country is so bad it needs external policing, and that the best way to ensure rectitude would be to join the European Union.

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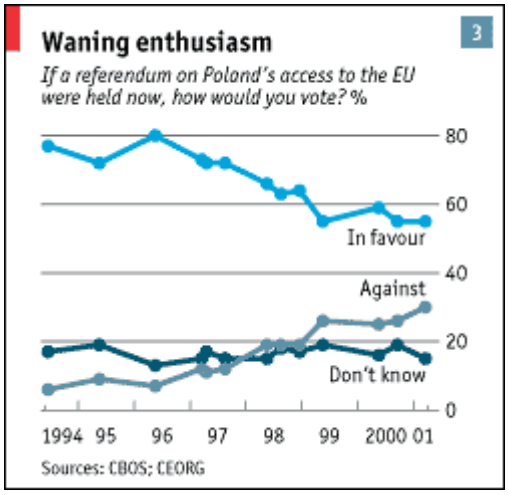
Looking west, looking east

Oct 25th 2001
From The Economist print edition

What EU accession will mean

MOST Polish politicians and negotiators are convinced by now that their country must become a member of the European Union. It is, as one says, a “no brainer”: join the club, or fall back under the influence of a resurgent Russia and be swallowed by the poor, unstable east. The Polish elite views EU membership as a return to the European fold after half a century of forced isolation.

On balance, the public agrees. Support for joining the EU as soon as possible has remained steady for the past two years, with roughly twice as many people in favour as against (see chart 3). The yes camp's cushion may be even bigger than that, because its supporters are more likely than its opponents to turn out for a referendum, now expected as early as next year. But apathy is still the main enemy. Even in 1990, Lech Walesa was elected president on a turnout of only 53%. And if fewer than 50% of the electorate cast their vote in the referendum, it will be null and void.



Opposition may yet grow. When Romano Prodi, the head of the European Commission, visited Poland earlier this year, he was pelted with eggs. Farmers are against going in, as are many nationalists and even some free-marketeers. A vocal minority thinks Poland should concentrate on rebuilding its eastern ties, and even mainstream politicians agree that the country should be looking both ways. “The Poles are no longer great lovers of the EU,” admits Bruno Dethomas, who heads the Eurpean Union's delegation in Warsaw.

One reason is that Poles have come to believe that the EU wants them as apprentices, not as equals. In opinion surveys, two-thirds say they will be “second-class members” for some years after they join. The vast majority also think the western members have their own commercial reasons for wanting enlargement. A few years ago, most Poles saw the EU chiefly as a source of financial aid; now they reckon that in the short term joining will bring more economic costs than benefits.

Negotiations over the terms of Poland's accession are about to enter their most difficult phase. The thorniest issues, left out of the early rounds of talks to ensure progress, will have to be tackled soon. On paper at least, Poland, the largest and most problematic first-wave candidate, has already fallen behind other applicants.

All applicants face the daunting task of adopting the 80,000 pages of EU laws and regulations known as the *acquis communautaire*. So far, Poland had closed only 17 of the 29 legislative “chapters” that must be completed prior to entry. That puts it behind every other country in the first wave, and on a par with second-wave Slovakia. One complaint is that Poland's negotiating structure is unwieldy, involving several ministries and other bodies in every big decision. The new government has promised to rationalise this.

The hard part

If Poland is to join the EU in 2004-05, as it hopes to, it will have to speed up negotiations and pass almost all the relevant laws by the end of next year. That will be tricky, because the hardest issues have been left till last. These include transport, state aid, tax and intellectual property. But the four most awkward items are:

• **Agriculture**. This is the worst headache, and negotiations have yet to begin in earnest. The Poles have

sought to play down the difficulties, but even they admit to 60 farming-related negotiating “problems”. The two biggest are quotas and subsidies. The EU wants to base the quotas of crops and animals that Polish farmers can sell on recent production levels. Polish negotiators argue that the levels should be set higher, because recent production has been much lower than potential farm output, and below actual output just before communism's demise.

The subsidy issue is even trickier. The EU's agricultural support system, the common agricultural policy (CAP), coddles its farmers at every turn. Under current plans, the CAP will not be fully extended to the Central Europeans because, Eurocrats claim, that would bankrupt the system, and there is no need for it anyway because prices for Poland's food will rise once it joins. The Poles argue that many prices are just as likely to fall. “The EU seems to be saying that we will have the same obligations as existing members, but not the same rights,” says Pawel Samecki, a top official on Poland's Committee for European Integration.

• **Sales of land to foreigners**. This is especially sensitive because of the dramatic changes in Poland's borders after the second world war. Formerly German territory in the west was given to Poland and resettled by familes from eastern Poland, which in turn became part of Ukraine. Many Poles fear that German families who were driven out will come back with papers proving they own property, or with enticing wads of cash. With land in Poland around a tenth of the price in Germany, that cash would go a long way.

The free movement of capital is a basic principle of the single market, but Mr Dethomas accepts that land is “a very difficult issue psychologically” for the Poles. They want an 18-year transition period before foreigners can buy land freely (at present they need permission from the interior ministry, which is rarely given). The EU seems prepared to offer Poland 10-12 years at most—but that is still more than the Czech Republic and Hungary will get.

It is not only Germans who want the EU to play tough on this issue. Poland's stance on land makes life difficult for foreign investors, no matter where they come from. Take IKEA, a Swedish furniture retailer the Poles should surely be delighted to accommodate: it has seven Polish stores, provides 6,500 local jobs and uses 130 local suppliers. Even so, it has so far failed in its four-year effort to buy a plot for an eighth store, near Lodz. Jan Musiolik, who runs IKEA's local operations, says local officials and interest groups have recently become even less obliging.

Agricultural investors find it most difficult of all to get land. A typical case is Ronnie Luteyn, a Dutchman who has been running a large potato farm in south-west Poland since 1995. He tried to buy the land, but was given only a 15-year lease—as well as 100 local buildings he did not want. For the first two years he was bombarded with inspections and fines. Now things are better, and “around half” of the locals accept him, he reckons. But he still cannot get title to his fields, which makes him reluctant to invest in long-term projects. Some foreign farmers have dodged the land restrictions by getting Poles to front for them, he says, but if they are caught they are likely to lose their farms.

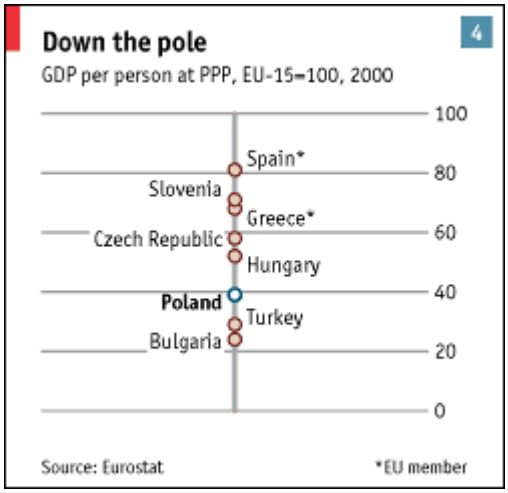
• **Free movement of labour**. The EU remains reluctant to open its labour markets to Poles and other Central Europeans as soon as they join, despite its skills shortages—so here it is Brussels that wants a transition period, of up to seven years. The Poles are pushing hard for immediate access. Many of them consider it more important to stand their ground on this issue than on land sales, because Polish unemployment is rising steeply.

Krzysztof Zagorski, director of CBOS, a Warsaw-based research centre, says the EU's fears of a deluge of foreign workers may be overdone. In a recent poll conducted by his organisation, only one in ten Poles canvassed said they were interested in moving west in search of work, and many of those may eventually decide against taking the leap.

• **“Cohesion” and “structural” funds**. Poland desperately wants the same sort of aid for its regions and infrastructure as poorer members such as Spain and Greece received in the past. It could certainly do with money for its crumbling roads and railways (see article). Under current rules, the Poles would easily qualify for such aid because their GDP per head is well below 75% of the EU average. But with so many poorer countries about to join, the EU wants to rewrite its rules.

The list is daunting, but things may not be as bad as they look.

Poland has made impressive progress in other knotty areas, such as the environment. Moreover, the number of chapters closed is a misleading measure of progress. In most of the chapters that remain open (except for agriculture), there is one big unresolved issue but, “If need be, these can be dealt with very quickly,” says Jaroslaw Pietras, the secretary of Poland's negotiating group. “If the last of the other applicants wraps things up on a Friday, we can follow on the Monday. All it will take is a few quick political decisions. The reason these have not been taken yet is that there's still time to hold out for a better deal.”



The SLD is keen to move things forward, and its less EU-friendly coalition partner has so far co-operated. Mr Miller is determined to get Poland ready to join the EU in 2004, even if he has to make big concessions on transition periods. He has said that entering the EU will be the third great moment in Poland's history, after its conversion to Christianity a millennium ago and its union with Lithuania in the 16th century that created an empire stretching from the Baltic to the Black Sea.

His enthusiasm owes as much to political expediency as to principle, though. With or without accession, Poland looks set for at least two years of economic hardship. If Poland is racing to adopt the European club's rules, some of this hardship can be blamed on Brussels. Mr Miller also knows that many Poles view EU membership as one of the government's main tests before the next general election in late 2005. “If he has not taken his country in by then,” says one foreign diplomat, “he can wave goodbye to re-election.”

Polish questions

As Poland draws closer to the EU, several questions loom. The first is about the sort of Europe it wants to be part of. When it joins, Poland will have 27 votes in the Council of Ministers, compared with 29 for Germany, which has more than twice as many people. The Poles will therefore be well-placed to help shape the debate. Mr Miller says he is something of a federalist, but there has been little domestic discussion of this issue. Janusz Reiter, a former Polish ambassador to Germany and head of the Warsaw-based Centre for International Relations, points out that “Poles actually discussed their place in the world more in the 1980s than they have done in recent years.” He says they are still struggling to define themselves. As evidence, he points to the post-communist constitution; seven years in the making, this has served the country adequately, but it is more of a messy compromise than a clear statement of values.

Then there is the question of what role Poland will have in the new Europe. Many liberal Poles think the main foreign-policy goal after joining the EU should be to strengthen ties with America, which has 10m citizens of Polish origin. George Bush sees Poland as an important ally, and stopped off in Warsaw on his way from Moscow in June. Poland's cosiness with America has already caused irritation within the EU. “Poland's dream is economic integration with Europe, but political integration with the United States,” grumbles one European Commission official.

Yet Mr Bush's trip points to another role for the Poles: as a broker in relations between NATO and the EU on one hand, and the Slavic trio of Russia, Ukraine and Belarus on the other. This may sound fanciful, but Poland, France and Germany have already launched an initiative called the Weimar Triangle under which ministers meet twice a year to discuss eastern issues. Once in the EU, Poland could use it to further its own interests in the east, just as Finland is already doing in the Baltic region.

Corbis

Plugging holes on the eastern border

It helps that relations with Russia have thawed of late. Seeing Russia as the great oppressor is part of the Poles' very identity. As Norman Davies, a historian, once put it, “The Poles expect the Russians to bully them and the Russians expect the Poles to resist.” But Poland is more relaxed now that it is in NATO. The Poles are particularly keen to rebuild economic relations with Russia. Trade between the two countries collapsed after 1989 and has stayed low, not least because the

EU has flooded Russia with subsidised food, undercutting Polish farmers. Russia, for its part, needs a friendly Poland as a transit country for its oil and gas pipelines to Germany and elsewhere in Europe. Vladimir Putin, Russia's president, is to visit Warsaw in January.

If Poland can carve out a role as east-west broker, its main client will be Ukraine. The two countries have strong ethnic ties and co-operate on many levels. Mr Kwasniewski, Poland's president, gets on well with his Ukrainian counterpart, Leonid Kuchma, and sees himself as a middleman who can help draw Ukraine towards the West. Once in the EU, the Poles will push for a softer line on Ukraine, whose human-rights violations have not gone down well in Brussels.

Conversely, some people worry that EU membership could in fact weaken Poland's eastern ties, especially those with Ukraine. This is because, when Poland joins, it will become the club's new eastern frontier. The EU, terrified of an influx of illegal immigrants, has been throwing money at Polish border crossings to make them less porous. It is also insisting that Poland reintroduce visa requirements for non-candidate neighbours. This will get in the way of the local cross-border trade on which many Poles and Ukrainians survive. Poland will also find it harder to get hold of cheap eastern labour. At present, some 300,000 Ukrainians are thought to work there as nannies, fruit pickers, construction workers and the like.

Such practical issues apart, there is a deeper reason why Poles worry about toughening up the border. Only 12 years ago, they were on the wrong side of the iron curtain. Many are reluctant to have a new curtain—albeit a softer one—drawn across their eastern flank. To them, it is yet further proof that EU membership is a mixed blessing.

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Road rage

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The country's transport system leaves much to be desired

POLAND'S dilapidated roads may well be the worst in Central Europe. Although it covers an area not much smaller than Germany, the country has a mere 300km (186 miles) of motorway, none of it near Warsaw, the capital. Most main roads have a single lane in each direction. Overtaking is terrifying but also increasingly necessary, given the swelling number of leisurely lorries that cross the country. On many stretches the tarmac, laid to withstand only light traffic, has sagged dangerously. When it rains, huge puddles form and cars aquaplane.

In March, the government unveiled a master plan to upgrade roads to EU standards by 2015. Some 15,000km of tarmac will be laid, of which 3,000km will become motorways or multi-lane access roads. The cost will run to $35 billion. Around half of the money will come from the EU-linked European Investment Bank and the EU itself. With Poland's public finances already stretched to breaking point, the government hopes to tease much of the remainder from the private sector.

Taking its toll

This means tolls. Three such projects are already under way. The first of these, a modest 65km stretch between Katowice and Krakow, opened in April last year and has proved a success. Around 75% of the traffic has moved from the old road on to the motorway, despite a charge of $2.50 (steep for a country where the average wage is $600 a month). The take-up for new toll roads in other countries has averaged 50-60% of the old traffic.

The rest will be tougher to pull off, admits Andrzej Urbanik, who heads the Agency for Motorway Construction. The Katowice-Krakow road is one of the busiest in the country. Negotiations over quieter routes have proved tortuous. Nervous private operators are insisting on government guarantees. As Mr Urbanik acknowledges, tolls have a poor record in emerging Europe. Hungary's much-vaunted M1 pay-motorway ended up being nationalised. The Czechs had to ditch their toll-road plans as uneconomic.

Time to head for the nearest railway station? Alas, no. The state operator, PKP, is losing lots of money and drowning in debt. The number of passengers it carries has been falling, so now it has 50,000 surplus employees and is being broken up. The company says that 25% of its track is substandard, but analysts suspect the real figure could be higher. Perhaps the railways need a master plan of their own.

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Economic and social reforms remain incomplete

FOR all its failings, the outgoing Solidarity government could not be accused of timidity. During its time in office, it launched four giant reforms aimed at making the country more efficient and accountable: of education, health care, local government and pensions. These were bold, but they also caused short-term economic pain, and the public found them too much to swallow in one gulp. Even though the government has changed, the reforms live on. How should they now be judged? And what others are needed?

The record is mixed. One reform was a failure, one a success and the other two somewhere in-between. The unequivocal failure was the reform of health care. The basic idea was sound enough: to take the system out of the hands of state officials by creating 18 regional public-sector funds, and at the same time encouraging private provision. A proper market is now slowly emerging. Private health-care schemes have become commonplace.

However, the reform had a host of unintended consequences. Some of the funds have become financially troubled because of poor management, for instance, and some hospitals have turned away seriously ill patients for fear of not being reimbursed. Doctors and patients are equally scathing about the changes. The new government says it wants to “reform the health reforms”, though it has yet to say how.

The two partial successes are the changes made in education and local government. As with health, both of these reforms were designed to decentralise power and decision-making. Something drastic was clearly needed in schools, because only half the population is educated above the most basic level of literacy (compared with over 90% in Scandinavia), and many children were leaving school with only a narrow vocational training. The school system was given an extra tier, teacher training was overhauled and the curriculum was broadened. But many schools in small towns and villages have fought against the changes, and teachers complain about increased red tape.

The local-government reform merged 49 largely small and powerless voivodships (governorships) into 16 regions with elected assemblies that control a good chunk of their tax revenue. Local government has been made more democratic but, now that local authorities can set their own salaries, also more corruptible. Squabbling over the voivodship mergers has produced inefficiencies of its own: two of the new regions have ended up with two capital cities apiece because neither contender would give ground.

Best of the bunch

If there is one area where the new government should resist the urge to undo its predecessor's reforms, it is the new pension system. Poles have two reasons to be proud of this. It was a triumph of cross-party consensus, and it was sensible.

Like most of Western Europe, before the reform Poland was facing a fiscal time-bomb, with the number of active workers for each pensioner expected to fall from four to three by 2020. But unlike its EU neighbours, Poland has now taken radical steps that will defuse the bomb. Under its new “multi-pillar” system, workers pay contributions into their own accounts rather than into a vast pool. These funds are invested in non-tradable bonds that pay a rate of interest linked to Poland's GDP growth. On retirement, the proceeds are turned into annuities. On top of this, 30-50-year-olds may contribute a portion of their retirement savings to private pension funds that invest in shares and other securities; for the under-30s, this extra pillar is compulsory.

At a stroke, Poland has done away with pension redistribution: what you get out is what you have paid in, plus interest and capital gains. The cost of providing pensions for those with nothing to pay in is borne by the central budget, not the new pension system, so the hidden debt in the system is no longer growing. Some 10.5m Poles have signed up with a pension fund—far more than envisaged—and 2-3% of GDP is now flowing into the privately managed funds each year.

One initial worry was that fly-by-night fund managers might jeopardise workers' savings. The system's designers got around this by insisting that funds meet performance targets or else make up the shortfall. That narrowed down the field to well-capitalised international companies, such as Nationale Nederlanden and Commercial Union. These two firms alone employ more than 12,000 local agents.

If the new pension regime has an Achilles heel, it is the state-owned institutions still associated with it. The reform relegated ZUS, the state social-security fund, to the role of a mere money-collecting agent, but ZUS is still causing problems. This year it has failed to pass on 5 billion zlotys that it owes to pension funds, citing computer problems. However, there are suspicions that the money is being deliberately kept back to help plug gaps in the central budget. Also, some of ZUS's government-appointed managers are cosy with those ailing state-owned companies that receive implicit subsidies by building up social-security arrears.

Marek Gora, one of the new system's market-minded architects, argues that ZUS will remain hidebound so long as it is in state hands; but privatisation remains politically unthinkable for now, even though ZUS is no longer at the centre of the system. Mr Gora also berates the state pension-funds watchdog, UNFE, for its “political and interventionist” style. For example, it wants to limit funds to a certain size, and to keep a lid on their investment abroad. But even Mr Gora admits that these flaws can be remedied without reopening the whole debate. The new system may not be perfect, but it works.

As one time-bomb is rendered harmless, however, another ticks ever louder. With unemployment approaching 20%, reform of the labour market has become essential. Until now, the left and right have always joined forces to block big changes to the strict labour code. This was negotiated in the early 1990s between the government and unions from mostly state-owned industrial conglomerates. Private business did not have a seat at the table, and has suffered as a result ever since.

Put simply, Polish workers are overprotected, which makes them expensive to hire. In some regions the minimum wage is 90% of the average wage, discouraging firms from creating jobs for less-skilled workers and school leavers. On top of this, workers have a plethora of rights and benefits. If your child is sick, for instance, you can stay home on full pay indefinitely. That might seem admirably humane, but it means that many firms avoid hiring people with young children. And an employer who wants to sack an incompetent worker often faces legal obstacles.

Panos

Pension reform made a clean break

One size doesn't fit all

Smaller firms, which were not involved in those labour-code negotiations, find themselves stuck with a

raft of obligations better suited to industrial giants. Companies employing more than five workers, for instance, must set up health and safety commissions with wide-ranging responsibilities, draw up detailed employee remuneration standards and “facilitate” the activities of trade unions.

Moreover, rules are often applied with disproportionate vigour, according to Henryka Bochniarz, the fiery president of Poland's private employers' confederation. She cites a complaint by the boss of an air-conditioning manufacturer about a 100,000 zloty fine imposed for the incorrect application of a tax exemption worth 6,000 zlotys. “Big companies can handle that kind of penalty, but it could easily drive a smaller firm out of business, and for what?”, she asks.

Indeed, tax is one of Ms Bochniarz's biggest gripes. The corporate-tax rate has been brought down in stages, and is due to reach a business-friendly 22% by 2004. But personal income tax is still high, with a bottom rate of 19%. A lower rate might persuade many more jobless people that work was worthwhile; at the moment, for many of them it simply does not pay. It would also help small and medium-sized businesses, which tend to pay income rather than corporate tax. But bringing down income tax is politically tricky. Past attempts have been shot down by populist politicians who claimed it would only make the rich even richer.

Add together tax and social-security contributions, and the average Polish company has to shell out up to 2.5 zlotys for each zloty that its better-paid workers take home. This encourages the under-reporting of wages, which appears to be rife. In some respects, things are getting worse. In March, parliament shortened the working week from 42 to 40 hours, further increasing already high payroll costs. And private businesses are expected to contribute to a “guarantee fund” that props up those (mostly state-owned) companies that have trouble paying wages. This was introduced as a temporary measure, but the state has come to rely on it.

The SLD-led coalition has pledged to close this Robin Hood outfit, but is it prepared to make more substantial changes? President Kwasniewski, who is close to the party, recently spoke of the need to “rationalise” the role of unions. Just before the election, the SLD said it would consider lowering income tax, but only for small firms. However, that would require the tax authorities to distinguish genuine entrepreneurs from those who set up shell companies to cut their tax bill.

The real trouble is that most Poles still consider established workers' rights inviolable, even as the economy turns down. Wlodzimierz Cimoszewicz, prime minister in the previous SLD-led government and foreign minister in the new one, sums up the mood: “There should be no sacred cows, but we can't accept a substantial reduction of workers' rights. With so many people without jobs, employers have the upper hand and want to become totally dominant. That is unacceptable.” But something will have to give if Poland wants to create new jobs—let alone save some of those in its rustbelt industries.

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Old habits die hard

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Traditional industries used to be Poland's pride. Now most of them are a liability

POLAND is proud of KGHM Polska Miedz, the world's seventh-largest copper miner and its second-largest silver producer. The company is a leading exporter and its equipment is state-of-the-art. Partially privatised in 1997, KGHM has since achieved big productivity gains in its core mining business and added telecoms to its portfolio. At Polkowice, one of its three pits, the headcount has fallen from 6,500 to 4,300 since 1996 whereas output has risen by a fifth. Recently, however, KGHM has been hurt by a falling copper price and by the telecoms slump, and in the latest quarter it slipped into loss.

Still, it is in better shape than most of the enterprises that emerged from communism. Smokestack industries, previously the economy's mainstay, became a liability overnight. State-owned mines, steel mills and factories remain a disproportionate problem: although most of Poland's GDP comes from the private sector, three-quarters of its tangible assets are in state hands. Most of these are deep in debt and bleeding money. Only one in ten communist-era enterprises is turning a profit. And many are still an environmental liability: despite its recent clean-up efforts, Poland still produces nearly three times as much carbon dioxide in relation to its GDP as the European Union does.

Until these industries are sorted out, Poland cannot claim to have a modern economy. Alas, privatisation could not provide the answer, because political deadlocks ensured it never happened. The previous government forced some restructuring on the sickest sectors, but they will have to shrink much further before they become viable.

Sickest of all a decade ago were the coal mines, clustered in the southern, formerly German, region of Silesia. In the old days, miners were the labour elite, paid three times the national wage and given access to all kinds of perks. When the old system collapsed, so did the perks. Worse, it became clear just how many subsidies the mines needed to keep them going.

The Solidarity government at least managed to make some progress with lay-offs. Coal-mining employment has fallen from a peak of 420,000 to 145,000, though all redundancies so far have been voluntary and severance packages generous, topped up by World Bank loans. The mines have also been merged into seven new groupings, each mixing good pits with bad. Some experts doubt the wisdom of this. Jan Macieja, a mining adviser based at the Polish Academy of Sciences, reckons that it has obliged the good mines to subsidise the rest with up to 25% of their revenue. Only one of the remaining 40-odd mines has been privatised.

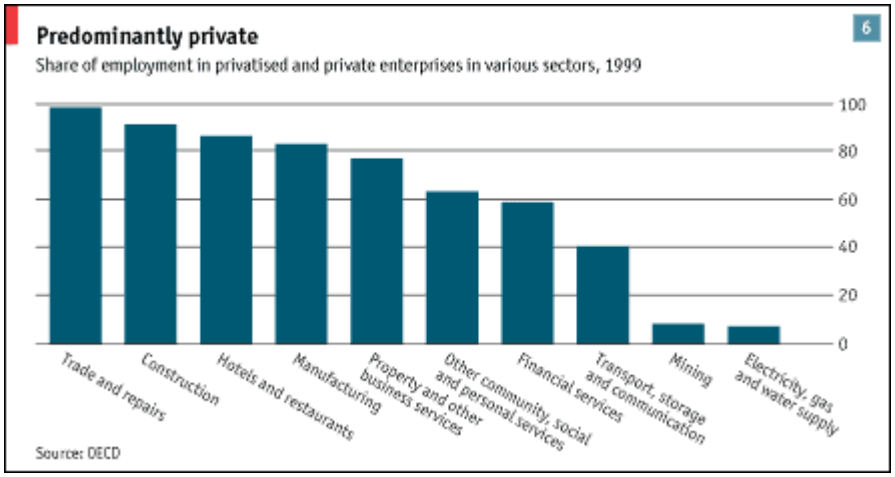
The Wieczorek mine near Katowice, the coal-mining region's capital, is one of the better ones. It has sold its non-mining activities—including a sports club and a loss-making brick factory—and is now turning a small profit selling its coal at home and to Western Europe, says Stanislaw Lyda, its managing director. Some 5,500 of its miners have gone, although at a price. To avoid unrest, they were offered a “miner's holiday”—75% of full salary until they reached pensionable age. Only around half of those who left have found new jobs, says Mr Lyda. That causes problems, because their relatively high pay under communism encouraged them to have more children, many of whom are still dependants.

Poland still relies on coal for 70% of its energy needs, but experts think the industry will need to lose another 70,000 workers before it can claim to pay its way. Transport costs play a part in this. Poland's rail network is so inefficient that moving a tonne of coal from Katowice to the port of Szczecin in the north costs $12-15, compared with $5 for a comparable trip in America. Against that, those high transport costs also keep exports out, especially in eastern regions.

Buckling

Poland's steel companies, too, face tough conditions, made even tougher by home-grown problems. For years, industry experts urged mergers on the least productive mills. Instead, the state allowed the mills to stay single and inefficient. Neither of the industry's two giants, Huta Katowice and Huta Sendzimir, makes steel good enough for domestic car producers, which import most of their metal sheets from Slovakia.

By last year, Poland's 30 or so mills were losing a combined $220m annually. Some loss makers were put up for sale at the end of the year; not surprisingly, there were no takers. Now four producers—including the two largest—look likely to be merged and sold as a package. Once again, foreign investors are mostly turning up their noses.



According to Marek Serafin, boss of Huta Zamierce, a medium-sized steel producer, government indecision caused steel bosses to sit on their hands. Only those few producers that were privatised early have been properly restructured—among them his own mill, which was bought by a private Polish group and is now profitable. Mr Serafin preaches western management techniques, picked up during stints with Arthur Andersen and South African Breweries. But he is a curiosity in his industry. Most of Huta Zamierce's competitors are still run by engineers who know a good steel rod from a bad one, but have few management or financial skills.

Poland's failure to spruce up its steel mills has caused rows with the EU. A new Polish law has placed strict limits on direct state aid, but has not yet stopped public-sector companies from receiving help via tax and social-security write-offs. And only last month, the state paid off a chunk of Huta Katowice's debt to local banks to save it from collapse. To free-market ears, this sounds regrettable. To be fair, however, it is broadly in line with EU practice: according to the OECD, Poland distributes aid worth 1-2% of GDP to industry each year, much the same as Germany.

Oddly, the exception to this sorry tale is that erstwhile hotbed of union agitation, the shipyards. When their old markets collapsed at the start of the 1990s, there were fears that the industry would disappear within a decade. But two of the three old yards, at Szczecin and Gdynia, are still open—and making money. The third, in Gdansk, went bust and was swallowed by nearby Gdynia in 1998. The industry has needed no state money since 1997.

The Gdynia yard was taken over by a group of its managers, who continued the rationalisation started a year earlier. Today, the yard is Europe's busiest, churning out 20 container ships a year for customers in Germany, Scandinavia and South Korea. The order book is full until 2004.

How was this turnaround achieved? Arkadiusz Aszyk, adviser to the yard's chairman, says the management buy-out was a critical element. Key decisions were left in the hands of old bosses, who understood the need for change and whom the workers trusted. Not that labour relations are universally friendly: Gdansk's unions are currently fighting a plan to lay off 500 white-collar staff at the yard.

Heavy emphasis

The World Bank, for one, has urged the state to sell its mines, factories and “strategic” defence concerns as quickly as possible. This might not save them all, but it would at least make investment decisions more rational. The SLD has vowed to concentrate its privatisation efforts on heavy industry, which it

hopes will boost the budget both by generating revenue and by removing the need for future subsidy. But proceeds this year will fall well short of the 18 billion zlotys originally expected.

If strategic buyers cannot be found, a stockmarket listing might be an alternative for some companies. Warsaw's stock exchange could certainly do with a shot in the arm: the index has fallen all year, and many of its past stars, notably Elektrim, a power-turned-telecoms group, are struggling. Others have been delisted by new foreign owners. That has left the market highly concentrated, with the five largest listed firms accounting for half of the total market capitalisation.

However, analysts say the stockmarket needs start-ups rather than dinosaurs. Few new companies have sought a listing. Instead, the exchange has become little more than a privatisation vehicle—and not all of those transactions have been resounding successes. The state retains a (usually malign) influence over partially privatised groups. A World Bank report on corruption last year concluded that board seats at such listed companies were determined by a “complex network of traded favours”. And because board directors change with governments, the quality of management suffers. The most damaging row has been at PZU, a giant insurance group whose sale to a Dutch investor in 1999 was challenged by the treasury minister on dubious grounds, then reinstated by his embarrassed successor. Poland is no exception to the rule that poorly handled privatisation can be worse than no privatisation at all.

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Terms of abuse

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The stockmarket has yet to bring good governance to companies

RECENT bust-ups between the state and foreign investors have made corporate governance one of the most talked-about issues in Warsaw's tight financial community. It does not help that ownership of companies is sometimes less than transparent. For instance, investors can often get away with “acting in concert”—forming a voting block—without reporting it to the stock exchange, as required. The law on this is adequate but enforcement is lax. “We can't do it all,” sighs Wieslaw Rozlucki, the boss of Warsaw's stock exchange. “For some things you have to rely on codes of conduct.”

That is fine for companies like Agora, Poland's leading media group. It is listed in London as well as Warsaw and maintains a higher standard of corporate behaviour than either stock exchange demands, according to ISS, an American shareholder service that gave it a governance award last year. But in Poland's rocky market, Agora stands out.

The best hope of improving the governance of some of the less well-run companies appears to lie with Poland's new breed of pension funds, which are already calling for tougher rules and fair treatment of small investors. But with interest rates high, they have so far put most of their money into bonds, not shares.

Bad example

On the face of it, encouraging more foreign capital should also help. But here the Poles feel increasingly ambivalent, and with good reason. Some of the most conspicuous recent abuses were perpetrated not by local tycoons but by supposedly upstanding foreign companies. In one notorious case, minority shareholders accused Michelin of siphoning off profits from its local tyre subsidiary. They called for the appointment of a new auditor, but Michelin hired an army of lawyers and dug up enough legal ambiguity to fend them off. ING, a Dutch financial group, has also come in for criticism over the terms offered to other shareholders when it took over Bank Slaski.

Such disputes have caused a backlash against foreign investors. Local lobby groups have made life difficult for foreign-owned hypermarkets and banks over the past two years. If the foreigners do badly, the criticism becomes even more strident. There was much resentment of the troubles of FSO, a local car maker, caused by the bankruptcy last year of its South Korean parent, Daewoo.

Concern that foreigners are out to plunder Poland's industrial jewels has become more intense in the past year or two. The optimists say that this is because Poles have discovered a commercial confidence they lacked a decade ago, when foreign money was the only game in town. But local capital is still scarce. For better or worse, western money will drive corporate restructuring in Poland for years to come.

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The other Poland(s)

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Capitalism has not been kind to Poland's rural population

Still Pictures

Tastes good, pays badly

POLISH cities may be drab, but these days they are also thoroughly modern. In Warsaw, Poznan or Gdansk, shoppers barely bat an eyelid at the latest trendy boutique, megastore or foreign fast-food outlet. Yet drive a few miles out of any of these cities, and the 21st century suddenly meets the 19th, complete with wooden barns and horse-drawn carts. The more remote parts of Poland's countryside do not even get copies of national newspapers. All the same, rural Poland is hugely important politically. This is where around a third of the country's population lives, and where a fifth of the national workforce is employed, a far higher proportion than in most other European countries. In hard economic terms, however, rural work produces very little: agriculture and related industries account for a mere 4% of GDP.

By some measures, life in the countryside has improved remarkably in the past decade. Monstrous state farms have been put in private hands, and telephone links as well as sewage connections have multiplied. Still, farmers form the largest pool of disgruntlement in Poland, and have good reason to feel that the market has done them down. Their incomes have fallen steadily since 1990. The average farm wage is now only 40% of what urban workers get, compared with over 100% in the 1980s. Proportionately, more farming folk now fall below the “minimum existence level” (basic food and shelter) than any other group in work. And for more than half of all farm workers, the main source of income is not agriculture but state benefits or black-economy jobs.

No wonder, then, that people talk increasingly of two Polands, urban and rural. In fact, there are more than two, because the countryside is itself divided. In the north and west, large former state farms are holding their own. The largest 20% of farms, mostly in these areas, produce 80% of the country's agricultural output. In contrast, plots in the east are mostly smallholdings, many of them only a hectare or two, with a few chickens or pigs. Most of these are subsistence farms that will not benefit from any agricultural subsidies that Poland may extract from the European Union.

According to official figures, rural unemployment is slightly below the level in cities, but that does not take account of hidden unemployment: those workers who are nominally employed in farming but do little or nothing that increases output. By some estimates, the numbers are vast. Andrzej Rosner of the Institute of Rural and Agricultural Development points to recent studies suggesting that as many as 900,000 people—or 6% of Poland's total workforce—fall into this group. And if Poland upgraded its farm technology to western levels, he says, 500,000 more farm workers would become obsolete. The social consequences are already apparent: alcoholism is rife in rural areas, and the suicide rate is twice that in towns.

Nor is there a quick and easy answer. Transport links, for example, cannot be improved overnight. Most companies prefer to cluster in or near built-up areas, even when offered incentives to go to more remote regions. The government is encouraging the development of organic-food production and green tourism, and multilateral institutions have lent money to improve rural infrastructure. But the effect of all this has been limited.

The best long-term solution lies in better education. Companies say that what keeps them in cities is the lack of qualifications among country dwellers. Moreover, rural children are no longer keen to take over the family farm. The problem is that village schools are still too poorly equipped with teachers and computers to provide a decent all-round education—which helps explain why only one-tenth of all Polish university students come from rural areas.

Young Poles in the country are still trapped by the system of vocational schools. A relic of communism, these train teenagers for a specific career, churning out people with a narrow range of skills to suit local needs. Since the recent education reforms these schools have played a less prominent role, but in some areas they still train half of all 15-18-year-olds. Many of the jobs for which they prepare students have disappeared.

For those who decide to make a go of farming despite it all, the future looks bleak. Many rural communities have been badly hit by the closure of local factories that were once important customers. For example, in the early 1990s the local steelworks in Ostrowiec, a town south of Warsaw, had 40,000 well-paid employees who bought much of the produce grown by local farmers. Today the company has just 3,500 workers, and the farmers have lost their captive market.

Ploughing on

Even those farmers who still have customers struggle to make money, given the competition from subsidised EU growers. Piotr Ryszard Maka bought a former state farm at Sanniki, 90km north-west of Warsaw, in a management buy-out with some colleagues in 1993. They had to assume all the debts of the old state farm and were obliged to buy all its movable equipment at market rates, paying 40% of the cost up-front. With “a lot of hard, hard work”, says Mr Maka, they raised production volumes each year and are now making a small profit. The farm, which grows mainly maize, sells it direct to international companies such as Cargill and Masterfoods.

Staying profitable is a daily struggle, though. Heavily subsidised French maize sells as cheaply in Poland as Mr Maka's does, and his costs have been pushed up by recent floods and storms. In Poland, insurance against such disasters is voluntary. Many farmers simply cannot afford it. That keeps the risk pool small and pushes up premiums. Mr Maka says he recently looked into insuring his crops and equipment, but the cost would have almost swallowed up his farm's annual profit.

Farmers are a dispersed and often fatalistic bunch who have not always proved adept lobbyists for their cause. They hope this will change now that their traditional political home, the Peasant Party, is back in the governing coalition. Some desperate farmers have rallied behind coarse populists. The most prominent of these is Andrzej Lepper, a barrel-chested pig farmer whose Samoobrona (Self-Defence) party demands huge subsidies for growers of cash crops. Mr Lepper says he is ready to lead Poland's “inevitable” anti-capitalist revolution. His party did surprisingly well in the election, winning 10% of the vote. That should be enough to cause a nuisance, but not to do any great favours for his rural supporters. They will still feel like Poland's forgotten souls.

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One more push

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Poles don't want to hear it, but to achieve the prosperity they crave they will have to accept a period of austerity first

FEW countries have been invaded and conquered as often as Poland, stuck between two of history's most bullying empires, Russia and Germany. It has been an independent nation for only 33 years out of the past two centuries. Poles love to tell stories of courage in the face of adversity, such as that of Prince Roman Sanguszko, a 19th-century Polish officer with the Tsarist Guards Regiment who fell foul of his Russian masters, was sentenced to exile in Siberia and forced to walk the entire way, clad in irons. He not only survived, but returned to Poland 14 years later and lived to 81 to tell the tale.

Poles have always proved remarkably protective of their national identity and resistant to being digested. Their rejection of the more extreme aspects of Marxism made it easier for them to emerge from communism after the iron curtain had come down. Poland developed its own brand of the faith, full of half-measures only partially carried out: many farms were left in private hands, the Catholic Church was left unsubdued and Solidarity was allowed to blossom in the rusting shipyards. Stalin once said that introducing communism to Poland was like fitting a cow with a saddle. More like strapping a yoke to a thoroughbred, Poles muttered behind closed doors.

Ironically, over the past decade the very institutions that had resisted communism in Poland have led the charge against liberal capitalism. The clergy, the farmers and the trade unions may not be able to stop reform altogether, but they still have the power to postpone it. Although Solidarity is a spent force, the church and the farmers got a boost in last month's election. Samoobrona (the radical farmers' union) and the Catholic-conservative League of Polish Families won a combined 18% of the vote. Moreover, the farmers' more mainstream Peasant Party could block reform from within the ruling coalition. Although it backs austerity measures, it is more doubtful about privatisation and land sales to foreigners.

But does it feel better? 7
Social indicators

	Human development rank*		Infant mortality per 1,000 live births		Life expectancy, years		Televisions per 1,000 people		Cars per 1,000 people		Cigarettes per person per day	
	1990	*1999*	*1990*	*1999*	*1990*	*1999*	*1990*	*1999*	*1990*	*1999*	*1990*	*1999*
Germany	12	17	7	5	75	77	526	580	476†	516	5.0	4.8
Poland	32	38	19	9	71	73	265	387	138	240	7.3	6.4

*Out of 160 countries in 1990 and 162 countries in 1999 1=top rank †West Germany
Sources: World Bank; International Road Federation; United Nations Development Programme; ERC

The success of these parties suggests that many Poles are tired of reform. Those who lost out when communism collapsed—state employees, farmers, pensioners and the unemployed—still feel hard done by. Never mind that most Poles are now better off and healthier than they were when the iron curtain came down (see table 7). Forget, too, that real wages have risen across the board, and that incomes are less unequal than in most other transition economies. At every turn, those disadvantaged groups are reminded that they are worse off than those who have embraced the capitalist spirit. Some of them feel that shared misery was better.

But just as many Poles are losing their stomach for hard reforms, so the need for them is increasing. The budget is in crisis, the economy is barely growing, and unemployment is shooting up. The new government has to pull off an unenviable balancing act between inflation and jobs, at precisely the moment when it must negotiate its way through a series of hoops to join the European Union. As Mr Belka, the new finance minister, has admitted, there is a real risk of social unrest.

Will Poland's journey into the EU have to be rescheduled? For now, Western Europe remains a strong

magnet. Even Samoobrona's eastward-looking leader, Mr Lepper, is not against joining the EU in principle. Most Poles still look west with admiration, albeit tinged with economic suspicion.

Poland's orientation towards the west has deep roots, moreover. For centuries the country saw itself as an outpost of Christian civilisation, keeping the barbarians in the east at bay. Although geographically it was undeniably in the east of Europe, in every other sense—trade, politics, culture, religion—its ties were in the other direction. Poles are a messianic people, many of whom see their country as having been a martyr among European nations, crucified over and over so that the continent could be purified and saved. Joining the EU will help to draw a line under past miseries.

Poland will be changed by membership, but so will the EU. Poles see themselves as more religious, patriotic and family-oriented than the typical European. Older Poles are also less go-getting than many of their EU counterparts; in the decades of Nazi and then Soviet occupation, seeking advancement was akin to treachery. Poles have been conspicuously reticent about trumpeting the Polishness of their famous countrymen, among them Copernicus, Marie Curie, Frederic Chopin and Joseph Conrad. The one exception is Pope John Paul II.

Yet although many older Poles remain disoriented and disillusioned by the market, their children exude confidence and entrepreneurial talent. And surveys suggest that Poles in most age groups have become steadily more satisfied with life over the past ten years even as they have become increasingly disenchanted with their governments. “They are learning to separate the public sphere from their private lives, just like in the West,” says Mr Zagorski, the polling expert. “They view democracy as a child who behaves badly but whom you love all the same.”

Nearly there

Poland entered the 20th century as a mere historical concept. It has entered the 21st as a confident, democratic nation with no threat to its borders and a good chance of a place at Europe's top table. Almost nobody wants a return to communism. The danger now is that the free-market machinery assembled over the past decade in fits and starts is dismantled or left to rust, when what it needs is fine-tuning.

The SLD's failure to win a parliamentary majority has increased that danger, as has the success of protest parties promising painless change. Yet contrary to what these populists claim, Poland needs to make adjustments that will be far from painless. If it is to stop spending money it does not have, to create new jobs and to build a foundation for renewed growth, then further sacrifices will be needed. But then if there is one European nation that has proved it can suffer and suffer, and still emerge intact, surely it is Poland.

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Media companies

Sucked into quicksand

Oct 25th 2001
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Ronald Grant

The advertising slump has battered the whole media industry, yet some groups look better placed to withstand the downturn than others

A FEW months ago, it was still fashionable to castigate Vivendi Universal, the French media giant, for its lingering interest in the sewage and water-treatment business. Vivendi, it was said, needed to shed such unglamorous activities and concentrate purely on consumer media. These days, however, Jean-Marie Messier, Vivendi's boss, lists the income from environmental services as one of the “strong defensive qualities” of the group. Even before the French government kindly knocked down the price of its 3G mobile-telephone licence last week, Vivendi's share price had held up while others' plunged. It is one of the few media groups not to have issued a profit warning.

To be fair, Mr Messier stresses that he is not about to abandon his plan to pull out of environmental services. Yet it is still a measure of how far the media industry has lost its shine. Scarcely a week goes by without another dismal report. Since September 11th, AOL Time Warner, Viacom and NewsCorp, three media giants, have each admitted that they will fail to meet financial targets for the fiscal year. In the third quarter of 2001, AOL Time Warner reported a net loss of $996m, 10% wider than in the same period of 2000; on October 24th, Viacom announced a net loss of $190m, with revenues down 2% on the same period last year.

Publishers have fared no better. Dow Jones, which publishes the *Wall Street Journal*, reported a 39% drop in ad revenues at its American publications in the third quarter from the same period of 2000. Pearson, a British publisher that owns half of *The Economist*, said last week that, if advertising revenues at its Financial Times Group remained low, that unit's full-year profits would be 40% down on the previous year. Primedia, a publisher, has had its share price decimated. There has been a rash of closures of such magazines as the *Industry Standard* and *Brill's Content*, whose parent is part-owned by Primedia. Job losses are mounting.

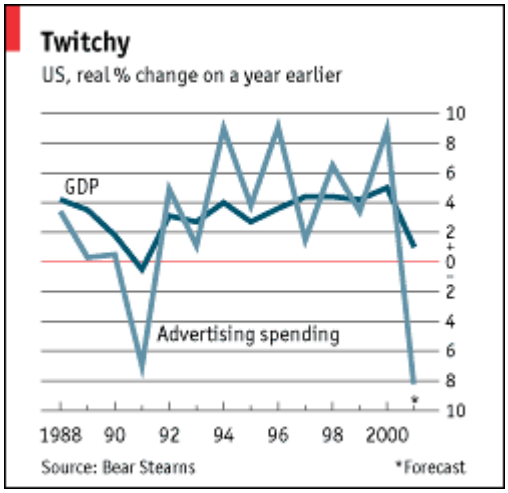
Some of these woes can be put down directly to September 11th. Companies with news divisions have been soaked twice: once by the added cost of dispatching crews and reporters to cover the attacks and the war in Afghanistan, and of the extra pages or news bulletins needed to cover these events; and again by the loss of advertising revenue. In the week of the attacks, the American television networks lost over $300m of ad sales thanks to their decision not to carry commercials for several days. Since then, advertisers have been especially cautious about any exposure that links them to bad news.

Yet most of the troubles now faced by the media sector were in place well before the terrorist attacks. In the first half of this year, overall ad spending in America had already dropped by 6% compared with the same period of 2000, according to CMR, a media-research group. It is the severity of the ad downturn since then that has come as such a shock. Total ad sales in America could be down by over 8% this year, according to Bear Stearns, an investment bank. Even the optimists expect no growth until the second half of next year at best.

The strong and the weak

How far can the media industry withstand this shock? Three factors stand out. The first is dependence on advertising. Ad spending is hugely volatile, and tends to exaggerate economic trends (see chart). It is one of the first costs that companies cut, and one of the last they restore. When ad spending does bounce back, however, it does so vigorously.

So those media groups that are highly dependent on advertising will suffer longer and harder from the downturn. This plainly hits broadcasters, such as Britain's Carlton and Granada, and France's TF1, and consumer-publishers, such as Primedia and EMAP. It also touches the big conglomerates: ads supply 46% of revenues at Viacom, which owns CBS, a TV network, and 56% at NewsCorp. It is no coincidence that investors are currently keen on firms which rely little on ads, such as Vivendi (1% of revenues), or BSkyB, a British satellite-TV company owned by NewsCorp, (11%). While Disney derives less than a quarter of its revenues from ads, it has been shaken also by the slump in travel and tourism at its theme parks and hotels.



The conglomerates may be able to withstand this ad squeeze better, since they can mop up some of their excess ad space to promote their own brands. Cost savings thanks to cross-promotion could be worth $1 billion to AOL Time Warner over three years, says Richard Bilotti, at Morgan Stanley, an investment bank.

The second factor is the diversity of other revenue streams. Not all aspects of media are weak. Subscription revenues are resilient in a downturn. Even if consumers want to cancel, contracts usually require a notice period. Often, they seem happy to keep paying. The take-up of pay-TV in France and Britain, and of cable TV in America, for instance, continued to grow during the 1991 recession. In the third quarter this year, AOL sold another 1.3m subscriptions, pushing its total to over 31m; revenues from subscribers were up 14% on the same period last year.

Other sectors offer diversity too. Pearson and Vivendi, for instance, have each pushed hard into educational publishing, a business far less vulnerable to the economic cycle. While several studios have put on hold the release of films now considered tasteless, the slowdown coincides with the take-off of sales of DVDs, the format replacing the video cassette. AOL Time Warner's sales of DVDs, for instance, jumped 44% to $279m in the third quarter. This might help to cushion media groups through hard times, when people tend to stay at home more. It also rewards those whose libraries are stronger than their recent creations. Disney has just released on DVD “Snow White and the Seven Dwarfs”, an animated film made in 1937.

When trading is tough, the quality of those assets not supported by advertising becomes even more critical. Diversity alone does not guarantee quality: for instance, BMG, the music division of Bertelsmann, a German media conglomerate, is losing money. Vivendi, by contrast, boasts not only the largest market share in music but, in the third quarter, in films too: its box-office takings were up 93% on the same period of 2000. Next month, AOL Time Warner releases “Harry Potter”, widely expected to be a blockbuster, with spin-off earnings expected in wizardry equipment, games and the like.

The third factor is financial strength. During the technology bubble, media groups splashed out lavishly on Internet-related projects, many of which flopped. “A lot of guys were still throwing money at new ventures until very recently,” says Nick Bell at Bear Stearns.

Now the market has turned, many new ventures have imploded, and debt levels are high. A crunch lies ahead. Primedia, for example, carries at least $2 billion of debt and reported a net loss in the second

quarter this year of $140m. European cable companies, such as Britain's NTL and the Netherlands'UPC, also look exposed. On the other hand, Viacom, Vivendi and Liberty Media, which have strong balance sheets, look well placed to sit out the downturn—and even to take advantage of buying opportunities created by it. Today, Mr Messier says, “cash is king”.

In a sense, the market is punishing the media groups for their profligacy. As Christopher Dixon of UBS Warburg, an investment bank, points out, if you strip out the Internet-related ad spending from last year, overall ad spending has continued to rise almost in line with its long-term growth trend. The downturn is forcing introspection and self-discipline. “In a very perverse way,” says Mr Dixon, “a slowdown is just what the doctor ordered.”

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Broadcasting in China

Unscrambling the signals

Oct 25th 2001 | HONG KONG
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China's government has officially embraced foreign media content

ON OCTOBER 22nd, Gerald Levin, the chief executive of AOL Time Warner, toasted Xu Guangchun, China's media regulator and a director of the Communist Party's propaganda department. The American giant had just become the first western media company licensed to broadcast directly to ordinary Chinese people. This came only days after the granting of a similar licence to Phoenix Satellite Television, a broadcaster controlled by a former Chinese army officer but based in Hong Kong.

In money terms, these are no big deals. The new licences cover only Guangdong province, which borders ultra-capitalist Hong Kong and is the central government's preferred test bed. Nor do the licences actually promise more access to this market, since both Phoenix and AOL Time Warner are already in it. Guangdong's local cable station, like most others in China, has been picking up and distributing their signals illegally for years. Phoenix claims to reach 42m households this way, Time Warner 10m.

This illustrates the government's dilemma. It fears losing control over the media, and has so far allowed foreigners to broadcast only into luxury hotels or compounds housing expatriates. But it wants to boost the industry—almost all of China's 217 cable stations are losing money, largely because they lack programming people actually want to watch. So local authorities have turned a blind eye to shenanigans such as carrying foreign content, as long as it is not blatantly subversive.

Naturally, this legal vacuum is not a sustainable business foundation, and the new licences provide welcome clarification. Yet, for the multinationals, they also incur a cost. The immediate quid pro quo—AOL Time Warner will broadcast a Chinese state channel in New York, Los Angeles and Houston—will attract little attention (and few viewers). But there are concerns that the western media giants currying favour in Beijing may be tempted to soften their editorial approach to China in more subtle ways.

The prime suspect is Rupert Murdoch's NewsCorp. Its Asian subsidiary, Star TV, run by Mr Murdoch's son James, not only owns 38% of Phoenix but is also negotiating its own licences with Beijing. NewsCorp executives are never shy about schmoozing the Communists, but James Murdoch perfected the art when he opined that Falun Gong was indeed a dangerous and apocalyptic cult.

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European business regulation

Bad vibes

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The EU's new directive on vibrations is bad for your company's health

OFFICIALS in Brussels grow incensed at the idea that the European Union specialises in mindless, job-destroying regulation. Presumably, therefore, the new directive on vibrations passed by the European Parliament on October 23rd is best understood as a landmark contribution to human welfare. In the name of protecting the health and safety of workers, the directive limits their exposure to vibrating objects. Many road hauliers and users of chainsaws, machine tools or dumper trucks will now find that the number of hours they can work will be cut. The EU argues that it has the right—nay the duty—to regulate such matters, both to protect workers and to ensure that all EU-based firms compete on a level playing-field.

Complying with this directive is likely to cost European industry billions. Britain's Health and Safety Executive estimated that the directive as approved by the EU's Council of Ministers could cost British industry £3.9 billion ($5.6 billion) over a decade. But it may be worse: this week the European Parliament voted through even more stringent “exposure limits”. Liz Lynne, a member of the European Liberal Democrats—the only political grouping to oppose the directive—says that workers will now be able to drive their fork-lift trucks or any other vibrating machinery for only two to four hours each day. The directive, she says, implies “massive cost increases for mining, construction and engineering companies”. For the moment, tractor drivers on farms are exempt—pending further scientific study.

Advocates of the measure respond with a shrug. Surely profits cannot be bought at the expense of workers' health, they say—and anyway, firms with brand-new machinery should have no problem keeping within the limits. Yet the health risks are vague. There is little dispute that “hand-arm vibration” as experienced by people using a road drill is potentially harmful. But the concept of “whole-body vibration”—of the sort experienced by dumper-truck drivers—is problematic. While the International Organisation for Standardisation says there may be a risk, no studies exist. The directive's sponsors protest that conducting such studies on people would be immoral. Critics reply that the EU's definition of whole-body vibration would rule out a jog in the park.

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Subsidies for European airlines

Turning off the tap

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State cash for Swissair and Sabena disguise the true picture

THIS week, a consortium comprising the Swiss government, leading Swiss companies and individual donors stumped up SFr4.25 billion ($2.6 billion) to enable most of Swissair to be reversed into its regional affiliate, Crossair. Meanwhile, Belgium's national airline, Sabena, in which Swissair is a big investor, is likewise being kept aloft by short-term government loans.

At first glance, these cases suggest that Europe is back to its old tricks, doling out generous subsidies to “strategic” companies. But they may prove exceptional. The European Union's transport commissioner, Loyola de Palacio, is determined not to cave in and restart the endless round of handouts that were poured into companies such as Air France, Iberia and Olympic Airways in the 1990s. The European Commission has allowed governments to cover the insurance risks and costs faced by airlines since the terrorist attacks last month, and is willing to consider compensation for flights cancelled when American airspace was closed for four days. However, Ms de Palacio has made it clear that aid is limited, even though the French and Italian governments have got out the begging bowls. She has vocal support from low-fare airlines, such as EasyJet and Ryanair, whose business is still booming as they cut fares further to keep their aircraft profitably filled.

The upshot of all this is that America and Europe are heading in different directions in handling the aftermath of the September 11th tragedy for the airline industry. America's federal government is providing $5 billion in cash, and a further $10 billion in loan guarantees, to shore up an industry that was heading for combined losses of $3 billion even before the disaster. Europe's flag carriers were also heading into the red as transatlantic traffic slowed. They are now complaining that their failure to secure an American-style rescue could put them at a disadvantage—for instance, if American carriers discount transatlantic fares to grab market share.

The EU's tough stance could have some beneficial effects, forcing Europe's big carriers to seek their own salvation. British Airways (BA), for instance, confirmed this week that it is talking with KLM about some sort of alliance with the Dutch carrier. It is also working hard to get its main alliance with American Airlines (AA) blessed with antitrust immunity on both sides of the Atlantic. BA is hurting badly because it depends on transatlantic routes for nearly all its profits.

BA is increasingly desperate to win approval for its “virtual merger” with AA by the end of the year. American regulators are unlikely to give the go-ahead unless Britain signs an “open skies” deal allowing American carriers greater access to London's Heathrow airport. By the end of the year, however, Brussels will probably have won in the courts the right to negotiate such deals at the level of the EU rather than national governments. That might complicate and delay BA's plan to pool its operations with AA.

Once an EU-United States open skies deal is done, perhaps next year, the European aviation market will be truly liberalised—allowing, for instance, BA to fly to New York from Paris or Brussels, and Lufthansa to do likewise from London. This will unleash real competition on long-haul routes and undermine any remaining justification for national flag carriers. No wonder many agree with Lufthansa's boss, Jürgen Weber, who recently predicted that within a few years there will be only three big European carriers: BA, Lufthansa and Air France.

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Bandwidth trading

Buying time

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In tough times, trading bandwidth makes even more sense than usual

CAN communications capacity, or bandwidth, be traded just like corn, coffee or oil? The answer, with some qualification, is yes. By doing business through a bandwidth exchange, buyers win lower prices and sellers can unload excess capacity. As telecoms firms recover from the over-exuberance of the past few years, everyone wants to cut costs and there is a lot of spare capacity lying around. No wonder bandwidth trading is booming.

Compared with trading other commodities, bandwidth has several advantages. Richard Elliott of Band-X, a leading bandwidth exchange, notes that bandwidth is quickly and easily transportable, without losing its value. Better still, by adding together two chunks of capacity that nobody wants—a link from Seattle to Stockholm, say, and another from Stockholm to Singapore—you can create something (a link from Seattle to Singapore) for which there may be demand.

But bandwidth has drawbacks as a commodity too. For something to qualify as a commodity, both buyer and seller must agree on its quality. This is not always easy with network connections. The role of monitoring the quality of connections, to ensure that sellers live up to their promises, falls to the bandwidth exchanges themselves.

Such constraints mean that, for the time being, the most popular forum for bandwidth trading is a spot market for voice minutes. Sellers offer to deliver telephone calls to a particular city or country where they have network infrastructure. When a call is placed from a buyer's network, the bandwidth exchange's switching system determines which seller is offering the best deal, and puts the call through. Each trade is anonymous.

Buying voice minutes through an exchange means that each telecoms carrier gets the best deal on every call, and is spared the hassle of setting up bilateral agreements with other carriers in parts of the world where it has no infrastructure itself. According to Curt Hockemeier of Arbinet-thexchange, a bandwidth exchange in New York that deals in voice minutes, this approach is also less risky: in the current climate, with many carriers in trouble, it is dangerous to sign long-term contracts for network capacity.

Another popular form of bandwidth trading is Internet Protocol transit, or the delivery of Internet traffic: establishing connections between Internet firms and backbone providers that can be reconfigured in response to changing prices and quality. Traditionally, buyers of Internet access have signed up for a year at a time, with the price fixed and quality unknown. Buying through a bandwidth exchange is far more efficient.

Exchanges currently handle only a small share of the world's bandwidth, though traffic through them is growing faster than overall traffic. The downturn strengthens the case for exchanges, says Marcus De Ferranti of Band-X, since they make it easier for telecoms firms to outsource things they cannot do themselves.

Indeed, a recent report from Analysys, a British consultancy, suggests that bandwidth exchanges will help to remodel the industry, which is switching from a vertically integrated model, where carriers try to do everything, to one where firms specialise in particular services. Exchanges make life easier for niche operators, which can concentrate on, say, running a long-distance route between two cities.

The next leap forward in bandwidth trading will be when it becomes easier to trade “circuits”, such as high-speed fibre-optic connections between two offices in different cities. At the moment, circuits take days to set up, so they are not as liquid a commodity as voice minutes or Internet transit, which can be

switched instantly. The provision of instant circuits should be possible eventually—though, as Mr De Ferranti notes, “it's been 18 months away for four years.” Only when this occurs will a proper secondary market in bandwidth emerge. Its commodity status will then be undeniable.

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MBA programmes

Back to business school

Oct 25th 2001 | BOSTON, CAMBRIDGE AND NEW YORK
From The Economist print edition

A gamble that more people want to take

TO TAKE a master's degree in business administration (MBA) at Harvard Business School, the first exclusively graduate business school and still, on most measures, the world leader, is not cheap. Tuition fees are $30,000 or so for each of the two years; other bills and living costs add another $25,000 a year. Add to that earnings forgone: the cost in recent years, for a clever 28-year-old, might well have been another $100,000 or so over the two-year programme. Surely only students with great confidence in their employability would take such a financial risk.

In fact, no. Business schools find themselves in a bizarre situation. They are struggling to find jobs for their current crop of graduates—but overwhelmed with inquiries from would-be students. While, on some estimates, more than one in five of this summer's MBA graduates is still job-hunting, all the signs are that there will be a bumper crop of applications for the class of 2004, whose students will begin their courses in September next year.

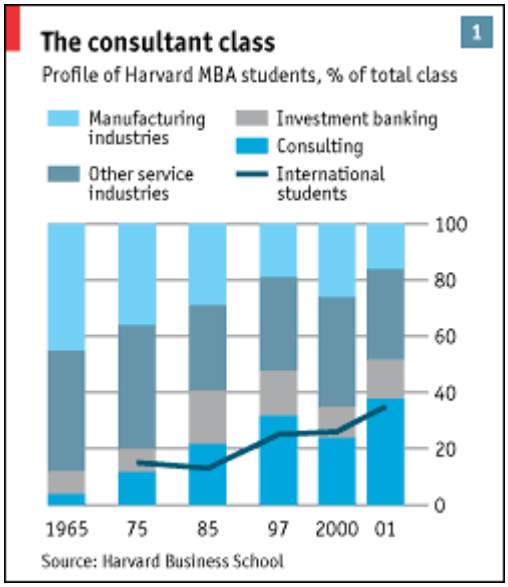
The unfortunate class of 2001 struggled to find employment, or discovered that promised jobs evaporated as the economy deteriorated. One reason for the popularity of the MBA is that it had become an entry ticket to lucrative jobs. “Investment banking and consultancy drive our business,” says Meyer Feldberg, dean of Columbia Business School in New York. As those two industries tanked, so did jobs and summer internships for graduates. At Wharton, the business school attached to the University of Pennsylvania, eight students saw their job offers rescinded and 38 had their starting dates pushed back. Almost all the culprits were consultancies.

Other schools have been similarly bruised. Even at Harvard Business School, some students are out of work: campus rumour says up to 20% of the summer's graduates, although school officials think that is much too high. But at least the top schools can protest: when a couple of companies dared to withdraw job offers to HBS students in particularly brutal ways, Kim Clark, the school's dean, promptly banned them from recruiting on the campus for the next two years.

Bad though 2001 has been, next year may be even worse. This is the season of campus recruitment fairs, but companies that once sent three or four recruiters to conduct eight interviews apiece may now send only one, and some are going to fewer schools, or (like Reuters, a media group) are making a presentation but not hiring. Booz Allen, a consultancy that normally makes job offers at the end of a first-year student's summer internship, is now postponing offers until December—if indeed it makes any at all. Because such employers have in the past usually paid a student's second-year fees, the effect is to plunge students into financial uncertainty.

Or to force them to look for alternatives. Back in the 1960s, students took MBAs mainly in order to run manufacturing companies (see chart 1). Maybe those days will now return. Dull old manufacturers are back in fashion. Cargill, a maker of agricultural feeds and fertilisers, saw attendance at a recruitment reception rise from 30 last year to 300 this year. Health-care companies are also attracting big crowds.

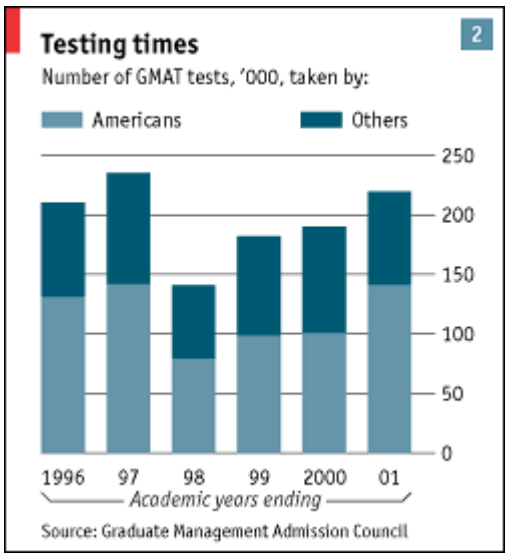
The dearth of jobs puts top business schools on the spot. Richard Schmalensee, dean of MIT'S Sloan School of Management, was annoyed to be told recently by a student that there was an implicit bargain: “I pass my courses, you find me a job.” He thinks students are not eager enough to use their own resources to look for work. Doug Breeden, dean of the Fuqua School, at Duke University in North Carolina, is exploiting the network of alumni to try to drum up new job prospects.



And still they come

However much today's students worry, plenty more would like to join them. Demand for MBA courses boomed for much of the 1990s, and then tailed off as the glamour of e-commerce lured students away. Columbia received 5,277 applications for this year's MBA intake, double the number in 1992 but down on the 1998 peak of 5,719. Now, though, the evidence suggests resurgent demand for next year. One indicator is the Graduate Management Admission Test (GMAT). Although the numbers do not take account of people who take the test repeatedly, the trend is sharply upwards (see chart 2).

Another portent is attendance at roadshows: Stern, an up-and-coming school attached to New York University, has seen a rise of 30-50% since September. Along with its full-time MBA course, the school runs a part-time course that takes in students twice a year. Applications for the spring course are up 50% on last year.



The rise in interest is not confined to the United States. American schools now recruit all round the world. Columbia's Mr Feldberg reports that this autumn's information session in London attracted 200 people, compared with 70 last year; the one in Paris attracted 135, compared with 60 last year, while “Toronto just blew everybody's socks off.” Business schools are mainly an American industry, but many European schools are prospering. INSEAD, France's top school, saw a 47% rise in applications for the current year's class. At HEC School of Management in Paris, Bernard Ramanantsoa, the dean, says that applications for the 18-month MBA course starting in January are 8% up on a year ago, when demand was flat. Smaller schools are more nervous: Didier Develey, dean of the Reims Management School, worries that people may now “reduce their investment in education”.

One reason for rising applications is doubtless the fall in opportunity cost: as companies stop hiring, students are less likely to miss out on that $100,000 consultancy job. Another is faith that business will once again be a lucrative career, and the MBA will remain the surest route to the top. In America, according to “Which MBA?”, published this week by the Economist Intelligence Unit (*The Economist*'s sister company), more than half the chief executives of big companies have MBAs.

For universities, the countercyclical nature of the demand for MBAs will certainly be a relief. Many universities, such as Chicago and Northwestern, draw a subsidy from their attached business schools. And executive education, an activity that business schools have been expanding even faster than MBA programmes, turns out to ebb and flow in line with the economic cycle, according to John Quelch, former dean of the London Business School. But the demand for MBA graduates may not quickly return to the boisterous levels of the 1990s. If the firms that do most of the hiring are not consultancies or investment banks, they may demand different skills: perhaps expertise in engineering or law, rather than a general understanding of business principles, acquired at great expense.

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Economist.com BUSINESS
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Compulsory licensing

Patent remedies

Oct 25th 2001
From The Economist print edition

Drug companies are not alone in facing the risk of having patents taken away

ANTHRAX does not affect the brain, but panic about the disease may well lead to seizures—of drug patents, at any rate. As America's anthrax scare spreads, its government wants to stockpile millions of tablets of Cipro, an antibiotic used to fight one of the nastier forms of the disease. The Department of Health has successfully negotiated with Bayer, the German patent-holder, for a roughly half-price discount on an order of 100m pills. Its chief bargaining chip has been a provision in American law that allows the government to turn to other manufacturers to produce a drug for its needs, as long as it compensates the patent holder.

Naturally, drug companies do not much like the prospect of losing their patents. As Jeff Kushan, a Washington-based patent lawyer, points out, the mere threat of involuntary patent transfer, known as compulsory licensing, is usually enough to bring them to the bargaining table. Brazil, for example, has used this approach to wring discounts on important anti-HIV medicines from Merck and Roche, two big drug firms. In America, compulsory licensing of drugs is rare. But it happens in other sectors. The government-use exemption in America, for example, was successfully employed by Lucent Technologies earlier this year to defend its use of a device patented by another firm because the work was done with federal authorisation.

The Department of Justice and the Federal Trade Commission also force companies to license-out their patents as a way of dealing with monopolies. For example, mergers are often made contingent upon companies relinquishing their patents to rivals in order to avoid market concentration. The union of two manufacturing companies, 3D Systems and DTM, was approved by antitrust authorities last month on condition that they license many technology patents to a third party. As Michael Scherer of Princeton University points out, such trustbusting patent transfers can profoundly alter the shape of the market. In the 1970s, for example, thousands of Xerox's patents were put up for grabs by the government, opening the floodgates to Japanese competition.

Jamie Love of the Consumer Project on Technology, a pressure group, wants to see compulsory licensing used more frequently in America, both to combat corporate patent abuse—such as unjustified attempts to spin out patent—and to create competition that will lower prices on essential goods, such as certain drugs. But making it hard for firms to keep their patents could hurt consumers too. Firms might move elsewhere to protect their research, taking their money with them, and might hesitate to launch new products for fear of piracy. As patent lawyers well know, there are many ways to get intellectual-property rights wrong.

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Face value

A South African Citizen Kane

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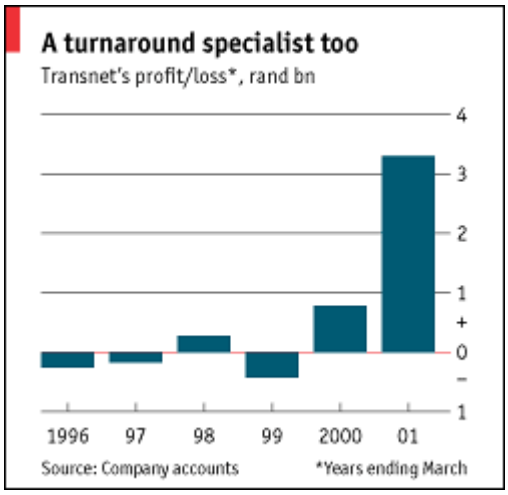
From The Economist print edition

For Saki Macozoma, business and politics are inextricably linked

MEDIA baron, black-empowerer, golden boy of South African business and perhaps even president-in-waiting, Saki Macozoma is clearly a man to watch. Once imprisoned by the apartheid regime, he has since raced up through the country's corporate ranks, and recently landed the top job at New Africa Investments Ltd (NAIL), a leading black-owned company—though still a minnow next to the white-run mining giants. Few would bet against his momentum carrying him much further yet.

Mr Macozoma is regarded as an inspiration for aspiring black businessmen. Only 44, he is following a white business tradition by gathering a bewildering collection of posts. Despite his new one, he will keep the deputy chairmanship of Standard Bank, the country's largest bank, as well as a senior role at Safika Holdings, a black-owned investment house, and a board seat at half-a-dozen other firms.

Before NAIL, Mr Macozoma ran Transnet, the state transport utility. There, he oversaw a dramatic turnaround (see chart). His touch has not always been golden, however, and the spell at Transnet could have finished his career. His controversial appointment of an American, Coleman Andrews, to rescue the national carrier, South African Airways, was a mistake. Mr Andrews has gone, more than 230m rand ($24m) richer for barely two years' work, and the airline (20% of which is owned by troubled Swissair) is in even worse shape than many of its rivals. Plans to sell the rest of the firm have been set back by at least a couple of years.



Despite this, Mr Macozoma has somehow managed to pass the blame for the airline fiasco to the minister for public enterprises. Such deft footwork was helped by his political connections. Incarcerated at the age of 19 for five years on the same island as Nelson Mandela, for organising student protests, he then spent most of the 1980s and early 1990s opposing white rule. By the time apartheid was tottering, he was official spokesman for the African National Congress (ANC). Then, as white South African businesses sought to recruit eligible black faces, he picked up a good job with South African Breweries.

Whereas other black political figures who went into business—such as Cyril Ramaphosa of Johnnic, and Tokyo Sexwale of Mvelaphanda—have made enemies of their ANC comrades in government, Mr Macozoma, who was a member of Parliament in 1994-96, has kept close to those in power. He is a member of the ruling ANC's national executive committee “because that is where the country's future is decided”, and is regularly seen with President Thabo Mbeki at business events, such as the World Economic Forum (the South African version of which Mr Macozoma hosted in June).

Like many black South African businessmen, Mr Macozoma faces the charge that he owes his position to such political connections, and that he has been handed assets rather than created any. Yet he is not merely a figurehead. He has rushed to split the firm in two: the finance part has been hived off and listed as New Africa Capital, leaving him to concentrate on media. Black businessmen have generally done far better in this industry than in others. Mr Macozoma has particular clout: his group owns the *Sowetan*, the

country's most popular daily newspaper, various magazines, a book publisher and large stakes in several radio stations, as well as TV and film-production groups.

President Macozoma?

These links help to spread gossip that Mr Macozoma will use his media interests to return to politics. He also happens to hail from the Eastern Cape, a region that bred both of South Africa's post-apartheid presidents, Mr Mandela and Mr Mbeki.

For the moment, Mr Macozoma insists that he prefers to stay in the wings, comparing himself with influential media barons of the past century: “Look at [William Randolph] Hearst or Lord Beaverbrook. It comes with the territory to be accused of having political ambitions. But we would be bankrupt very soon if we didn't follow business principles. Whatever ambitions I have must be tempered by business imperatives.” But he admits to having editorial interests, at least: the *Sowetan*, for example, should be an “alternative voice” to the rest of the local press, while still willing to criticise government policies.

And what of using his political clout to boost his business interests? In charge of two FM radio stations, he now wants to take over a third, but is prevented from doing so by regulations that limit ownership. He has lobbied hard for a relaxation of the rules, and was this week waiting to hear if he will get his way. The rules were originally tightened to encourage small, black-owned stations. Mr Macozoma argues that black presence in radio is now high enough not to need artificial support. Various white-run businesses have argued much the same, but “we have credentials as a black-empowerment company,” says Mr Macozoma.

He is not the first to benefit from having friends of the same skin colour in high places. But, unlike many other well-connected bosses, he is quick to call for the government to withdraw as soon as possible from running, and meddling in, ordinary businesses. Earlier this month, he told a conference of black managers that the government must restructure state industries more quickly. It missed opportunities to sell its telecoms and transport companies when unions were less opposed and when market conditions were better. Sell-offs would not only strengthen government coffers and boost productivity, he argues, but would also “provide a platform for black people to build viable, world-class businesses, to be a vehicle to join the global economy.”

Bold talk, especially since both black empowerment and privatisation are sputtering. But then, no doubt, Mr Macozoma imagines rich pickings would be waiting for ambitious businessmen, such as himself, if both processes were speeded up.

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Investment banking

So long, banker

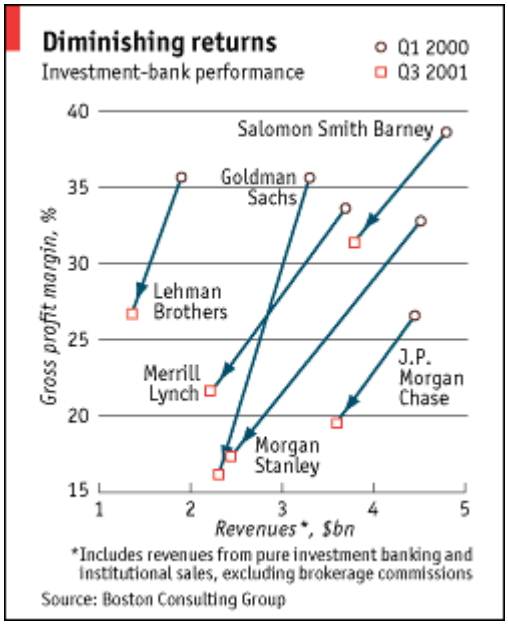
Oct 25th 2001 | LONDON AND NEW YORK
From The Economist print edition

Investment banks are having a dreadful year, with thousands of jobs cut. The future looks no better

Get article background

WAS it only last February that Jack DiMaio's threat to quit prompted his employer, CSFB, to offer the bond trader a 50% pay rise, to about $45m over three years—guaranteed no matter how he performed? These days, investment banks are desperate for their workers to quit. With as much hope as realism, CSFB is trying to scrap the guaranteed pay packages it awarded to Mr DiMaio and many others, and is axing 2,000 bankers. On October 22nd, Merrill Lynch invited most of its 65,900 staff (though not its 15,000 brokers in America) to apply for voluntary redundancy, in order to help it cut about one-sixth of its workforce.

Investment banking is now in its worst recession since the mid-1970s. Given the rapid growth and globalisation of the industry—worldwide employment in investment banks has risen by about four-fifths in the past decade, to around 400,000—the scale and reach of this slump is unprecedented. Since the salad days of just 18 months ago, worldwide revenues from investment banking have fallen on average by 43% at the big firms, and profits by 49%, according to Boston Consulting Group (BCG). Morgan Stanley saw the largest fall in revenues, and Goldman Sachs the sharpest fall in profitability, between the first quarter of 2000 and the third quarter of this year—though every investment bank has suffered.



Banks have suffered most in those areas that grew fastest. Underwriting initial public offerings (IPOs) of shares is one of the juiciest bits of investment banking. In the first quarter of 2000, $144 billion of equity capital was raised worldwide in IPOs, but only $44 billion in the third quarter of this year; there were no IPOs at all in September. Advising on mergers and acquisitions (M&A), another lucrative business, has also had an awful year. Deals announced in the first nine months of this year were worth $1.5 trillion, half the levels of a year earlier. The falling value of shares has cut the fees from asset management. Goldman Sachs has seen the fees from managing the assets of private clients drop from over $25m a week to less than $18m.

Lively markets in underwriting corporate bonds offset this to a degree—admittedly, mainly in investment-grade bonds, where the fees are slim, rather than junk bonds, which are more profitable. Credit derivatives have fared well, too. Providing brokerage to financial institutions, from pension funds to hedge funds, has also grown strongly, since fund managers have been adjusting their portfolios to reflect changing economic times and greater stockmarket volatility. Online trading by individuals, on the other hand, has ground almost to a halt. Who wants to turn on the computer, says Richard Strauss at Goldman Sachs, when looking at your portfolio makes you feel sick?

Until recently, investment banks had been reluctant to make deep job cuts, for fear of damaging their franchise—something Merrill Lynch did in 1998-99, when it fired a lot of employees at a time of market

crisis only to have to try to rehire them a few months later. Is Merrill making the same mistake again? “I can't believe how they have done this,” says a boss of a rival firm. “How can you possibly instil confidence in your employees when you offer all of them redundancy?” Stanley O'Neal, who has taken over day-to-day management from Merrill's chief executive, David Komansky, has recently made several decisions that appear to many to be unduly aggressive: more about establishing that he is in control than implementing good strategy. On the other hand, Merrill's employee costs, as a proportion of revenues, are second only to CSFB's—and every other investment bank is looking at each bit of its business in search of cuts.

Uncertainty reigns. “Investment banks really do not know whether to prepare for a disastrous year or a more ordinary one,” says Svilen Ivanov of BCG. Investment banks with headquarters in New York seem to be taking the most aggressive approach to cost-cutting. Don Layton, co-head of J.P. Morgan Chase's investment bank, says that in this uncertain environment you “don't want to bet your life on a forecast. This makes you more interested in a flexible cost structure, and more radical in cutting.” Chip Mason, the head of Legg Mason, a brokerage based in Baltimore, says that his counterparts in New York have a more aggressive approach to cuts than his firm does, because the terrorist attacks happened there.

A recovering economy should help to revive M&A activity. Yet “pure” investment banks such as Goldman Sachs and Morgan Stanley may continue to lose out in M&A to investment banks attached to large commercial banks—the likes of Deutsche Bank, CSFB (owned by Crédit Suisse) and Salomon Smith Barney (part of Citigroup). These can offer cut-price loans to corporate clients in order to win M&A business. In his firm's defence, John Thain, one of Goldman's bosses, argues that the slump “has made competition from fee-cutting by banks less effective, as clients feel a greater need for the best ideas and best execution.” Still, the problem is not going to go away.

Investment bankers in Europe are rather more upbeat than their American counterparts. As some doors close, others open: if their equity business has slumped, their bond business is brisk. Institutional investors may not be buying IPOs, but they are certainly hedging, which keeps equity and interest-rate derivatives desks busy. Companies that cannot raise money by selling shares are issuing convertible bonds. And some private-equity players, with nerves, look forward to action in six months' time, when companies begin to shed unwanted divisions.

Deutsche Bank, ABN Amro and J.P. Morgan Chase, hybrid investment and wholesale banks, are taking comfort from their more boring “annuity” businesses—foreign exchange, custody and transaction services—which are less sensitive to business cycles. That is a cushion against their more volatile investment-banking returns. But what may not be clear before the end of the year is the damage done to loan books. Investment banks are not immune: how many short-term bridging loans have been repaid since September 11th?

As they wield the axe, the heads of the biggest investment banks hope that they are merely chopping away the forced growth of the past two years, bringing a healthier cost structure back to the industry. The success of this strategy of “back to normal” hangs on a strong recovery in the economy, America's and the world's, during 2002. If that does not transpire, far deeper cuts will be unavoidable.

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About sponsorship

Hitting terrorists' cash

The financial front line

Oct 25th 2001
From The Economist print edition

A worldwide attempt to stop finance for terrorists

"THIS is not a macho task," said Kenneth Dam, the American Treasury's deputy secretary, rather "a thinking man's war": in the end, diplomacy, vigilance and seamless information-sharing will cut the terrorists from their financing.

In recent days, America, Britain and the European Union have announced legislative and regulatory measures to get at the terrorists' funding. Next week, at an extraordinary meeting of the Financial Action Task Force (FATF), the world's main anti-money-laundering body, America and Britain will seek agreement on steps to force the rest of the world to join the campaign against terrorist financing. They will try to make a new handful of terrorist-related rules binding on all countries, not just the 31 members of the FATF.

Governments will be expected to ratify the United Nations convention, signed in 1999, for the suppression of the financing of terrorism, to agree to share information and to make it a crime to finance terrorists, whether or not the source of their money is "clean". Governments will have to introduce a reporting system for suspicious transactions, take on legal powers to freeze terrorist assets, and extend all of these rules beyond mainstream banking to money-service businesses, including the *hawala* system, Islam's version of the correspondent banking that was once practised by medieval Europe's Lombards. The FATF will ask all countries to take these steps, if they have not done so already, by the middle of next year. If they resist, it will publish a name-and-shame list and, possibly, later apply sanctions.

Forceful, perhaps, but countries have little time to meet FATF demands. The task force will need moral authority, as much as international law, to extend its reach beyond its own members and sister groups. So officials are keen to have sanctions-enforcement folk from the United Nations involved, to gain more legitimacy.

Persuading countries to pass new laws will be relatively easy. Enforcement will be another matter. In the United Arab Emirates, an economic consultant in Dubai points out, most bank staff are South Asian immigrant workers on tenuous contracts. They will not want to challenge rich locals for documentation. And if, say, Saudi Arabia does little more than legislate, will the FATF have the authority to go there, test its systems and complain?

Targeting *hawala* methods for transferring money will also be tricky. By their nature, *hawala* networks are hard to pin down. Migrant workers in the Gulf states and elsewhere use this trust-based system to send billions of dollars back home, winning on both efficiency and cost. When the editor of a Dubai newspaper sent a reporter to Quetta to cover the war in Afghanistan, he found it faster and cheaper to send expenses money through *hawala*. How to track illegitimate funds?

An obvious target for those leading the fight against terrorist financing is the world of offshore banking. Legislation now making its way through Congress will give America's treasury secretary new powers to stop American banks doing business with others in jurisdictions that he decides help money-launderers. Offshore banking centres will be subject to special scrutiny. Britain's chancellor of the exchequer, Gordon Brown, recently suggested that offshore centres are potentially the weakest link in the struggle to cut off terrorist funds.

Tax havens are by now used to such attacks. In recent years they have dealt with three international initiatives against them, starting with the OECD's campaign against harmful tax practices, and then with the Financial Stability Forum's investigation in 1999 into whether they contribute to world financial instability. Most recently, nine island nations found themselves slapped on the FATF's blacklist of 19

nations thought to indulge money-launderers; eight are now there.

Because of all the attention, many offshore centres have tightened their legislation and supervison. In the crucial area of corporate transparency, says Michael Levi, professor of criminology at the University of Cardiff, Jersey and Guernsey have tighter controls than Britain, where it is possible to conceal the identity of the beneficial owner of a company. The Cayman Islands has made improvements in order to get off the FATF's blacklist. More respectable offshore centres, such as the Channel Islands, resent being lumped together with laxer places such as Nauru and the Cook Islands. In any case, they say with justification, money-laundering also involves big, “onshore” centres.

How much pressure offshore centres face in the coming months will depend upon how deep an intrusion into individuals' financial privacy policymakers are prepared to make in order to clamp down on the nefarious uses of financial institutions. Because of the role that offshore centres play in allowing companies and individuals to avoid, indeed evade, tax, they enjoy powerful backing. Most well-known banks have branches or subsidiaries in tax havens. They have also been, according to Mark Hampton, an author on tax havens, useful to western intelligence services setting up covert operations. Over time, though, increased scrutiny and regulatory tightening will further reduce the distinction between onshore and offshore, and erode demand for the havens. One healthy outcome, you might argue, of the war on the financing of terrorism.

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Northern Afghanistan's economy

Inefficient frontier

Oct 25th 2001 | FAIZABAD
From The Economist print edition

War-zone prices are far from transparent

Get article background

Reuters

Two men, one bike: sub-optimal

IN LESS than a week, the Afghani, the currency in anti-Taliban northern Afghanistan, has doubled in value against the dollar. Blame the influx of several thousand high-spending foreigners into a small and poverty-stricken economy, as well as collapsing confidence in the Taliban-issued money in the south. Oddly, the monetary authorities seem not to have thought yet of printing more banknotes to sterilise the dollars.

A jeep ride to the front—three bone-shaking days—used to cost a few hundred dollars. Now the going rate is a few thousand. Each newcomer lacks information on supply and demand; while such uncertainty prevails, the only direction for the price is up. A translator with broken English costs $100 a day. Three weeks ago, good ones cost $30. Pepsi tracks the same index, while Coke cannot be had for love or money.

On the road, an old man with a home-made pickaxe was this week providing a public good (dealing with the foot-deep ruts) in exchange for voluntary donations of 20,000 Afghanis (24 cents) from each driver. Almost all pay up. A few miles on, another man with the same idea angrily demands more. In the meantime, as the Taliban's hold on power weakens, the price of defection drops. For a few thousand dollars the commander of a small force can change sides.

Money doesn't drive everything. On the road, the idea of free riders takes on a whole new meaning. When a bunch of cheerful men with submachineguns ask you to give their friend a lift, you don't say no. However, there is a Pareto-optimal solution (a change that makes everybody better off): shift some of the baggage into the cab, and enjoy bumpy gasps of fresh air together in the back, where extra bodies matter less.

There is also the influence of do-gooders. Aid organisations find that transaction costs are lower if they use food rather than money to make things happen. Refugee families that send their sons to school (rather than make them work or beg) get 12.5 kilos of wheat each month. If they send their girls (who in poor Afghan families traditionally stay at home), they get the wheat plus 2.5 litres of cooking oil.

Airport officials at Dushanbe, the capital of next-door Tajikistan, haven't got the idea at all. The price of an air ticket to opposition-controlled Afghanistan is a flat $400. Perhaps this betrays nostalgia for some lost Soviet idyll. Surely an auction process is called for, and would make money, given the pressure on seats. An embassy staffer dismisses the idea as shameful.

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The downturn in East Asia

Warning signs

Oct 25th 2001
From The Economist print edition

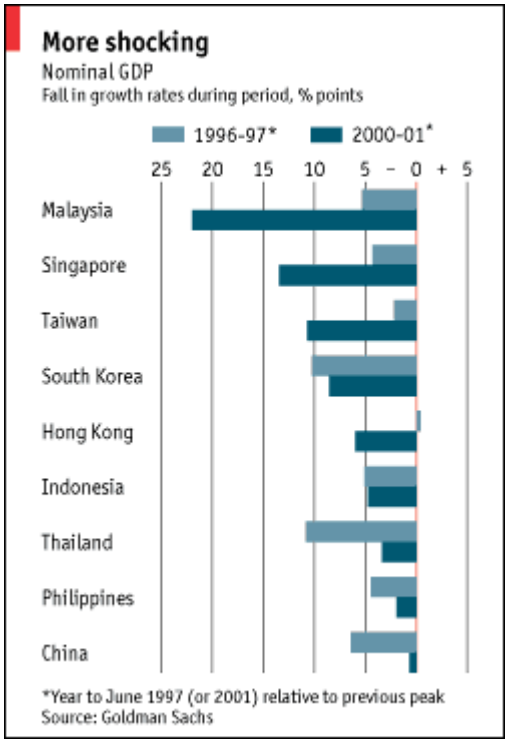
Asia's slump could once again strain the region's financial system

THE economic news from East Asia gets worse by the day. Singapore is suffering its worst recession for almost 40 years: real GDP fell by 5.6% in the year to the third quarter. Taiwan, Malaysia, Hong Kong, Thailand and the Philippines are already in or close to recession. How vulnerable is Asia to another financial crisis?

In 1997 pegged exchange rates, high foreign-currency borrowing and weak bank supervision left many Asian financial systems horribly vulnerable to a sharp fall in exports and capital outflows. Most of the region's economies now have flexible exchange rates, current-account surpluses, large foreign reserves and sounder banking systems—all of which suggests that another crisis is unlikely. But a new report by Sun-Bae Kim at Goldman Sachs in Hong Kong reaches a more sobering conclusion: not only is Asia suffering a more severe economic shock than it did before the crisis of 1997-98, but its financial system is, overall, no stronger than it was then.

One gauge of the size of the economic shock hitting the financial system is the slowdown in the rate of growth of nominal GDP. This is a proxy for the capacity of the economy to generate cash flow, from which debts must be serviced. Most economies have seen a much sharper fall in nominal growth over the past year than leading up to the 1997 crisis (see chart). In Malaysia, the year-on-year rate of nominal GDP growth has fallen from 20% in early 2000 to minus 2% in the second quarter of this year.

How bad this cash-flow shock is depends upon the level of private-sector debt, and upon how many of the outstanding loans are already non-performing. In East Asia as a whole, private-sector debt is smaller in relation to GDP than in 1997, but non-performing loans now amount to 15% of GDP, up from 11% before the 1997 crisis.



If the economic shock is bigger, do financial systems have thicker buffers than in 1997? They certainly look healthier today on various measures of liquidity. In 1997 foreign lenders triggered a liquidity crunch by refusing to roll over loans. Today, the foreign borrowing of the financial system amounts to 30% of foreign-exchange reserves, down from 70% in 1997.

On various measures of solvency, however, many Asian financial systems look wobbly. The average capital-adequacy ratio of the banks is slightly lower than at the end of 1996. Ratios of government debt to GDP are much higher today than in 1997, leaving governments less able to bail out banking systems again. Public-sector debt has risen from an average of 28% of GDP at the end of 1996 to 45% of GDP today.

The worrying conclusion is that although Asia's financial system is less vulnerable to a sudden liquidity crisis, there is a risk of a deeper, more drawn-out deflation, exacerbated by domestic debt—similar to that in Japan. China alone looks better placed than in 1997: the economic shock currently hitting China is milder than in the lead-up to the previous crisis, when deflation was more severe. Nor does its financial system look significantly more exposed (thanks largely to a currency that is only partially convertible). Goldman Sachs reckons that the most vulnerable financial systems are in Malaysia, Taiwan, Thailand and Indonesia.

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Italy's charitable foundations

Odd sort of ownership

Oct 25th 2001 | ROME
From The Economist print edition

Consolidating Italy's poorly-performing banks

ONE of the oddities of Italian finance is this: a great swathe of Italy's banks are owned not by institutional investors under pressure to produce returns. Rather, they are owned by charitable foundations, on whose boards sit cronies of local governments. Is it a coincidence Italy's banks are reckoned to have the worst credit quality and the poorest returns in Western Europe? Some foundations even feel some action is now needed at the banks.

Consolidation is back on the agenda. On October 19th the Compagnia di San Paolo, the Fondazione Cassa di Risparmio di Padova e Rovigo and the Fondazione Cassa di Risparmio in Bologna announced that they had reached an agreement under which Cardine, an 800-branch bank, will become part of Sanpaolo IMI. By absorbing Cardine, a non-listed institution in which the two *fondazioni* are the controlling shareholders, Sanpaolo IMI (where the Compagnia is the biggest single shareholder) will move from third to second place in the national banking rankings, measured by capital.

This came two days after the board of UniCredito Italiano, the second-ranked bank that will slip to third, approved plans for an organisational shake-up that will need the assent of a trio of *fondazioni cassa di risparmio*, with 37.6% of the bank. For minority shareholders in Sanpaolo IMI and UniCredito Italiano, that underlined who calls the shots.

The origins of the bank foundations lie in the public-sector banks that dominated Italian banking until the first half of the 1990s. Under a 1990 law, these banks, more than 80 savings banks (the *casse di risparmio)* and a handful of credit institutions that included Monte dei Paschi di Siena (which claims to be the world's oldest bank) were required to spin off their banking activities into joint-stock corporations. Ownership of the shares went to newly established charitable foundations.

Over the past 11 years, only nine foundations have withdrawn completely from the spun-off banks. The Fondazione Cassa di Risparmio di Venezia is one of these; its sale of a 10.9% stake in Cardine to Sanpaolo IMI at the beginning of this year opened the way to the recent deal. The shareholding, Giuliano Segre, the Venetian foundation's chairman, admits, “gave very low returns”.

According to the Associazione fra le Casse di Risparmio Italiane (ACRI, which represents the foundations' interests), a quarter of its members still own stakes of more than 50% in the spun-off banks. When Monte dei Paschi di Siena floated its eponymous bank in June 1999, the share offering put almost 2.8 trillion lire ($1.3 billion) into its coffers.

The Sienese foundation is one of the richest. Wealthiest of all is Fondazione Cariplo, which once owned all of Italy's biggest savings bank, the Cassa di Risparmio delle Provincie Lombarde (Cariplo), and now owns 9.9% of Intesa BCI: it has assets of around 13 trillion lire. ACRI says that, together, the bank foundations had 69 trillion lire of assets at the start of this year.

With this wealth, the foundations spend on good works. The 1990 law laid down that income should pay for education, culture, health care, conservation, scientific research and help for the deprived. For example, the Compagnia di San Paolo has helped museums in Turin, and has put *euro*25m ($23m) into cancer research. Milan's Fondazione Cariplo assists the elderly in the Lombardy region and helps La Scala in Milan. On October 17th, ACRI announced the first disbursements outside Italy, through a fund with an endowment of 6 billion lire to aid Italian-Americans affected by the terrorist attacks on September 11th.

Far from getting out of banking, the foundations are now in it on a national scale. Mergers over the past five years have brought several large banks into their grip. Fondazione Cariplo and the Fondazione Cassa

di Risparmio di Parma together have 14.8% of Intesa BCI. Credito Italiano and Rolo Banca are now under the thumb of foundations that control UniCredito Italiano. In 1999 Monte dei Paschi di Siena completed the purchase of two mid-sized, private-sector banks. And two years ago, Banca di Roma, in which the Fondazione Cassa di Risparmio di Roma is the biggest shareholder, acquired Mediocredito Centrale, which controlled Banco di Sicilia.

Now that Sanpaolo IMI has won Cardine, Banca Nazionale del Lavoro (BNL), which had also been interested in it, looks vulnerable. Despite its privatisation at the end of 1998, there is speculation that BNL itself will fall to Monte dei Paschi. The minister responsible for the 1990 law has since described the foundations as Frankensteins. Whether they have created monsters is open to question. One thing is certain, however. The foundations' appetite for banking seems undiminished.

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Economics focus

Dollar mad?

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From The Economist print edition

Argentina's troubles have increased doubts about currency boards

THE deepening crisis in Argentina is more than just the latest emerging-market meltdown. The country's troubles come with a twist. A decade ago Argentina fixed its currency, the peso, against the dollar in an unusually binding way. This arrangement worked fairly well, promoting stability and growth for much of the 1990s. Now it is being blamed for Argentina's plight.

A currency board fixes Argentina's exchange rate. The central bank maintains foreign reserves to back the (narrowly defined) money supply in full, implicitly promising to convert all local currency into dollars if need be. This makes the peg as credible as it can be, short of outright dollarisation. In principle, it should immunise the economy against the sorts of speculative attacks that plagued South-East Asian countries in 1997-98.

In the 1990s, currency boards were widely regarded as a good solution for economies troubled by high inflation and financial instability. Steven Hanke of Johns Hopkins University, for one, travelled the world urging poor countries to adopt the method. A few successes—Hong Kong (pegged since 1983), Bulgaria and Estonia—supported currency boards' reputed stabilising powers. Argentina had suffered a decade of rising inflation, and two bouts of hyperinflation, when the economy minister, Domingo Cavallo, introduced a currency board in 1991. At first the results were impressive, but now the economy is in a hole. Where does this leave the currency-board debate?

Rudiger Dornbusch of MIT, not shy of contrarian positions, has published a new defence of currency boards. He argues that, Argentina notwithstanding, boards have virtues that can outweigh their drawbacks*.

As Mr Dornbusch concedes, currency boards involve costs, from the political to the practical. First, countries must swallow their pride and abandon their “monetary sovereignty”: henceforth, interest rates are set not locally but, in effect, in Washington, DC, or Frankfurt. Second, currency boards require the government to give up seignorage—the implicit profits from printing money. Third, the fixed exchange rate can get badly out of line with those of trading partners. A strong dollar has hurt Argentina, while its neighbours have devalued to boost their economies.

Yet the benefits are great, too. One is lower inflation. Another, which Mr Dornbusch emphasises, is that currency boards help to curb wasteful government spending. The inability to rely on printing money to finance deficits focuses minds wonderfully. In the five years after the introduction of the currency board, Argentina pruned spending and subsidies dramatically. This did not happen at the expense of economic growth: the economy grew on average by 6% a year during 1991-96.

According to Mr Dornbusch, the causes of Argentina's current troubles are deeper than its overvalued peso. They include the legacy of high debt and earlier deficits, trade unions that have consistently thwarted reform, and obsolete industries producing goods so shoddy that they would be uncompetitive at almost any exchange rate.

In fact, it is wrong to separate all these issues from the currency-board debate. Argentina's notoriously intransigent unions were always likely to make it harder to get good results from a fixed currency. And although the currency board stopped the government from printing money, it enabled excessive borrowing from abroad—a big part of the crisis now. Still, Mr Dornbusch's main point, that it is wrong to blame the currency board for all of Argentina's ills, is surely right.

Getting real

Today, currency-board sceptics point to Brazil. Like Argentina, it struggled with years of high inflation before taking its own reform path. It chose to manage exchange rates after introducing a new currency, the *real*, in 1994. Arminio Fraga, in charge of Brazil's central bank (and a former student of Mr Dornbusch), managed to convince the markets that this was the better approach—notably in January 1999, when a speculative attack forced a devaluation in the *real*. Then, Brazil saw only a blip of inflation and a relatively brief pause in growth.

Does the comparison between Brazil and Argentina settle the matter? Not really. Brazil has been fortunate to have a skilled and convincing central banker, and a government dedicated, for a time, to fiscal prudence. (Lately, this commitment has waned, and inflation is rising.) All Brazil and Argentina really prove is that no currency regime is a cure-all, and that there is no substitute for sound fiscal policy.

If Argentina breaks its dollar peg, as now seems likely, it will be wrong to declare currency boards a menace under all circumstances. For many countries—especially if they are small, open to trade and lacking a central bank with inflation-fighting credibility—they may be the best insurance against hyperinflation. For larger countries, such as Argentina, the choice of foreign-exchange regime is bound to be more difficult. Thanks to the currency board, Argentina cut inflation and held it down. And Argentina has suffered plain bad luck in the recent, possibly anomalous strength of the dollar.

If, a decade ago, Argentina had known what it knows now, would it have chosen a currency board? Probably not. But even as default looms, it would be wrong to conclude that Argentina's policy has been an unmitigated disaster, or that, regardless of circumstances, a currency board is always the wrong solution.

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*"Exchange Rates and the Choice of Monetary-Policy Regimes", by Rudiger Dornbusch. *American Economic Review*, Volume 91, Number 2. (Mr Dornbusch's paper is posted with a different title at the above link.)

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Space exploration

The search for intelligent life at NASA

Oct 25th 2001
From The Economist print edition

The departure of NASA's chief is causing speculation about the agency's future

Get article background

AS RECENTLY as 1995, most NASA scientists still wrote their computer programs in FORTRAN, an ancient programming tongue invented in the 1950s. Some of them still do. America's space agency (strictly, the National Aeronautics and Space Administration) is not renowned for making sudden changes. It came as a surprise, therefore, when two of its top officials resigned their posts within a day of one another, just over a week ago. Daniel Goldin, who served as the agency's chief administrator for nearly a decade, and Joseph Rothenberg, who was in charge of the space-shuttle and International Space Station (ISS) programmes, insisted that the timing of their departures was mere coincidence. It is an even odder coincidence, then, that this should occur while the agency deals with one of the worst budget crises in its history—an overrun of roughly $5 billion on the ISS and the prospect of further funding cuts from Congress.

This bizarre constellation of events is prompting much soul-searching at NASA, as it looks back on an era marked by both notable accomplishments and striking failures. Successes during Mr Goldin's tenure include the mending of the *Hubble Space Telescope*, the dispatch of the *Mars Pathfinder* mission, which put the first craft on that planet's surface since the 1970s, the launching of several deep-space exploration probes and, most recently, the successful arrival of *Mars Odyssey* (see article). On the debit side, attempts to make cheaper reusable launch vehicles met with no success, and two missions to Mars that were supposed to follow the trail blazed by *Mars Pathfinder* were lost. Most disappointing of all has been the performance of Mr Goldin's most expensive achievement, the much-vaunted ISS. At a cost of $2½ billion a year (together with $3 billion a year for the shuttle programme, on which it is critically dependent), it is now an orbiting reproach.

Most researchers not connected with the station regard the science done on it as pointless

Originally, the ISS was planned to house six or seven astronauts. At the moment, it carries a skeleton crew of three, and will do so for the foreseeable future. Such a small staff can spare only 20 man-hours a week to perform scientific experiments, which were the advertised reason for the station's construction. NASA's research projects alone cannot be completed in such a short amount of time, so the agency's international partners in Europe and Asia have little but scientific crumbs to feed on. Worse, some scientists from Naples recently presented a paper suggesting that the structure of the station produces “non-negligible disturbances” in micro-gravity experiments—in other words, jitters—that might make their results unusable. In any case, most researchers not directly connected with the station regard the science done on it as pointless.

As this record indicates, Mr Goldin's tenure was a time when the agency suffered from the simultaneous pursuit of two contradictory goals. On the one hand, he doggedly sought to cut costs and produce spacecraft under the motto “faster, better, cheaper”. On the other, he maintained the agency's dedication to manned space flight, which is none of those things. The chief challenge facing NASA now is to decide how to get out of this fix.

T minus 5 billion and counting

A number of evaluation committees set up by Mr Goldin will release their findings in the next few months, and these may be of some help in plotting the way forward. One of these reports, written by Thomas Young, a retired aerospace executive, will evaluate the management and costs of the ISS. Though it will not be released officially until November 1st, Mr Young's report is rumoured to be brutally honest in its evaluation of the station's future prospects.

A second report, by Courtney Stadd, the agency's chief of staff, looks into NASA's new policy towards commercialisation. This document will discuss ways to create “space commerce”—meaning ways to coax private money into space. A leaked draft indicates that NASA intends to open itself to collaborations with advertisers, merchandisers and the entertainment industry.

If it did so, it would be following in the footsteps of the Russians. Earlier this year, with uncharacteristic entrepreneurial spirit, Russia's space agency gave berths on the ISS to a Pizza Hut pizza, an issue of *Popular Mechanics*, and an American millionaire, Dennis Tito, who paid $20m for the privilege. This week, also at Russia's behest, a Japanese drinks maker is shooting a television commercial aboard the ISS.

Will such shenanigans take place under American auspices as well? NASA's policy, according to the draft, would not extend as far as letting the space shuttle be rented for transport to the ISS. However, it does suggest that limited tourism on the station itself might be acceptable. Bob Jacobs, one of NASA's spokesmen, says that the international partnership running the ISS will soon release its criteria for accepting prospective travellers (apart from the obvious one of being very rich, of course).

Other than that, the notion of how to “privatise” space—a resource that companies are already free to use if they feel they can profit from it—remains a fuzzy one. Earlier this year, Dana Rohrabacher, a congressman who chairs the House of Representatives' Subcommittee on Space and Aeronautics, sponsored a “zero-gravity, zero-tax” act that would give tax breaks to companies and people who invested in or profited from space technologies. But, as Keith Cowing, the editor of NASA Watch (a self-appointed, online, guardian of the public good), says, “there is a difference between the government giving companies money to give the impression of commercialisation, versus the government opening up space to the factors that drive commercialisation.”

The principal one of those factors is, of course, the profit motive. That has driven successful businesses that run communications and earth-observation satellites without any help from NASA. But it is not clear that there is much profit to be had from the space station. Spacehab, a company based in Texas, could not coax a single private firm into purchasing room aboard a module, called *Enterprise*, that it proposed to add to the ISS. Now, Spacehab is reduced to trying to sell *Enterprise*, which has yet to be built, to NASA as an extra “habitation” module.

In the face of this sort of thing, Mr Goldin and Mr Rothenberg may actually have chosen rather a good time to jump ship. A government agency spending taxpayers' money trying to privatise a common good sounds like an idea that Gilbert and Sullivan might have turned into a jolly little operetta. If that is the best on offer, it might be time to close the whole thing down.

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Mars Odyssey

Safely into harbour

Oct 25th 2001
From The Economist print edition

After two embarrassing failures, NASA has got a spacecraft successfully to Mars

EPA

Yah! Boo! Sucks! You missed me!

Get article background

ODYSSEUS took ten years to get home after the Trojan war. The American space probe named in his honour, which went into orbit around its destination during the early hours of Wednesday morning (London time), travelled rather faster: *Mars Odyssey* was launched only in April.

Its successful arrival is particularly welcome, because two previous missions to Mars by NASA, America's space agency, in 1999, ended in failure. *Mars Polar Lander* did touch down, but refused to report back to its controllers. *Mars Climate Orbiter* went sailing merrily past the planet owing to the slight problem that one group of its engineers was working in metric units, and another was using imperial ones.

Navigating a craft to Mars, and then getting it to stop there, is clearly still a difficult feat. In the early days of Mars exploration, after several failed missions, one of NASA's engineers joked that a Great Galactic Ghoul must be protecting the planet. As the fates of *Mars Polar Lander* and *Mars Climate Orbiter* showed, the Ghoul is still hungry. The fact that *Mars Odyssey* sneaked past it is a happy ending to the tenure of Daniel Goldin as the agency's administrator (see article).

Mars Odyssey will not actually open for scientific business until January. The intervening weeks will be spent in a manoeuvre called aerobraking, which involves using the air-resistance of the thin Martian atmosphere to change the elliptical initial orbit into a circular one from which the planet's surface can be examined in detail. Using aerobraking means that *Mars Odyssey* did not need to be fitted with special retro-rockets. That design feature fits in with the third part of Mr Goldin's famous “faster, better, cheaper” mantra for missions planned during his watch.

Once the aerobraking is over, the satellite's instruments and cameras will swing into gear. A thermal-imaging system will map Martian rocks according to their mineral content (different minerals have different thermal spectra). This device may also be able to identify hot springs, if they exist. That would excite biologists, since on earth such springs are the habitats of specially adapted bacteria.

A gamma-ray spectrometer will also help in the search for water, by measuring the amount of hydrogen in the planet's regolith (the soil-like powdered rock that covers much of its surface). Oxygen, water's

other chemical constituent, is common in rocks. Hydrogen is not, so if a lot of it is present, water (or at least ice) is the most likely explanation.

And, for those space-cadets who still dream of a manned mission to the planet, there is also the Mars radiation environment experiment. This will help to establish just how lethal it would be to send people to the place.

Beside its direct scientific role, *Mars Odyssey* is also an important link in America's Mars-exploration programme. That is because it is designed to act as a relay station for signals from subsequent missions. This means that these missions will need less in the way of power-packs to send their signals back to earth.

The first of them should be two vehicles known as Mars exploration rovers. These will, as their names suggest, crawl over the surface taking samples and pictures. They will arrive in 2004, assuming the Ghoul has not got its appetite back.

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Geothermal energy

A smash hit in Lake Malaren

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From The Economist print edition

It may be possible to extract useful energy from old meteorite craters

A LITTLE over a decade ago Herbert Henkel and Borje Bergman, of the Royal Institute of Technology in Stockholm, came up with the idea that meteorite craters might provide a short-cut to the problem of extracting the earth's heat and doing something useful with it. Geothermal energy, as it is known, is cheap where it is available, but that tends to be in places that are volcanically active (Iceland, for example). The punctures in the earth's crust that vulcanism causes act as conduits through which water can flow into the planet's interior. There, it is heated up (the temperature of rock rises 1°C for every 35 metres you go below the surface), sometimes to temperatures above normal boiling point, although the pressure underground keeps it liquid. Once heated, it frequently returns to the surface in the form of hot springs and geysers. Water heated above boiling point is particularly valuable as it can be used to generate steam with which to turn turbines, and thus generate electricity.

Dr Henkel and Dr Bergman reasoned that such punctures can be made from above, as well as below. The shock waves from a meteorite's impact smash the rock beneath, making it up to ten times more porous than its surroundings. Water then seeps through the cracks, and is warmed in the same way as volcanic water.

Although this water might not be hot enough to turn turbines, it would be ideal for the sort of district-heating systems favoured by community-minded Scandinavian town planners. And, conveniently, there is a crater 10km (6 miles) wide underneath Lake Malaren, the body of water at the outlet of which Stockholm stands.

The impact that created the Malaren crater (which happened about a billion years ago) fragmented 250 cubic kilometres of rock. This could store a lot of heat: as much as 4,000 terawatt-hours, according to Dr Henkel. That is ten times Sweden's annual heat consumption.

To test the idea, Dr Henkel and his team have begun boring into the Malaren crater in order to map its cracks. Their first hole, just under 1km deep, was completed in August, and water with a temperature of 40°C (warm enough for district heating) is flowing out of it. A second hole is currently being drilled, and a third is planned for next year. By 2003, it should be clear whether the Malaren crater can yield a reliable, and commercially viable, supply.

If it can, that would be good news. About a quarter of Sweden's energy consumption is used for heating. Sweden also needs new energy sources, because the country has decided to phase out nuclear power by 2010. Since nuclear energy still accounts for a third of its energy production, some rapid substitution is going to have to take place. Importing fossil fuel is one solution, but the environmentally minded Swedes are unhappy about the greenhouse-gas implications of burning more coal, oil and natural gas.

If Dr Henkel is right, they might not have to do so—or, at least, not to the same extent. The crater under Lake Malaren is about 10km from three heating plants that supply Stockholm with warmth. And there are at least nine other meteorite craters in Sweden that could be brought into production—several of them near cities. New meteorite impacts are generally thought of as a bad thing, because of the destruction they might bring. Old ones, though, look as if they may have their uses, after all.

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CJD

The end of the affair?

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A new mathematical model suggests that Britain may escape a CJD epidemic

PEOPLE in Britain might be forgiven for doubting any announcement made about "mad-cow disease" (bovine spongiform encephalopathy, or BSE) and its human version, new-variant Creutzfeldt-Jakob disease (nvCJD). The litany of lies, half-truths and evasions that has emerged from successive governments represents official backside-covering of the worst sort. The latest debacle, the posting at night of a press release that tried to weasel out of acknowledging a cock-up, while simultaneously putting it on the record, is all part of the same pattern. That cock-up was the fact that some scientists who thought that they had been looking for signs of BSE in sheep brains, were, unbeknown to them, studying cattle brains.

There is, however, some good news. A study just published in *Science* has examined the epidemiology of nvCJD in order to estimate just how bad things could become. Its conclusion is that, even if several million people have been infected (which cannot yet be ruled out, since no easy test is available for those who are still alive), the number of deaths from the disease is unlikely to exceed a few thousand.

Previous attempts to predict the course of nvCJD in Britain have relied on projections from the existing caseload. The model used by Jerome Huillard d'Aignaux and his colleagues at the London School of Hygiene and Tropical Medicine works the other way round—by back-calculation from various possible futures, to see which might be consistent with the number of cases already known.

The model suggests that this number is consistent with a wide range of infection, from a few thousand, to many millions. What is important to the individual, though, is not whether he is infected with nvCJD prions (as the proteins that cause the disease are known), but whether he will actually develop the disease.

It is here that the news is good. If Dr Huillard d'Aignaux's model is correct, a high infection rate implies a long incubation period. And the longer the incubation period, the more likely an infected individual is to die of something else. If millions do turn out to be carrying the prion, that suggests an average incubation period significantly longer than an average human lifetime. This would mean that even widespread infection would not result in many more deaths a year than are happening already. No thanks to officialdom, though.

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Contemporary art

Mosques and modernity

Oct 25th 2001 | ISTANBUL
From The Economist print edition

A treasure hunt for modern work among ancient monuments, the Istanbul Biennial is a celebration of culture's fundamental unity

A TURKISH bath at the Istanbul Biennial has given a whole new meaning to the nude in art. In this extraordinary art installation, female viewers in the inaugural week were invited to strip down and lather up (massage optional) for a performance in the women's section of the Cemberlitas Hammam—Istanbul's most famous bath house, designed by Mimar Sinan, the great 16th-century mosque builder and Ottoman answer to Michelangelo.

Inside the bath house, a Bosnian artist, Maja Bajevic, staged a performance by (clothed) Bosnian refugees. Several women stood in the steam bath washing tattered fabrics embroidered with patriotic slogans. Tired phrases from Marshall Tito's day—"With the youth that we have, we should not be afraid of the future"—were hung out to dry. Using women's work—sewing and washing—to give voice to the silent and secondary victims of war, Ms Balevic turned the *hammam*, traditionally a place of care and conversation, into a personal and political art space.

Unusual convergences of old and new, East and West, lie at the heart of the Istanbul Biennial. Since 1987 the organisers have invited curators from across the world to come to live in the waterfront city and fill its historic spaces with cutting-edge art. This makes the Biennial (which runs until November 17th) one of the most exciting and accessible of the big international art shows. Viewers find themselves on a treasure hunt through the city's rich mix of historic monuments, including the Topkapi and Dolmabahce palaces, the Hagia Eirene church and the imperial mint.

Unsuspecting visitors to the 6th-century Yerebatan cistern will be surprised by the animations and sculptures of a Korean artist, Lee Bul, that seem to levitate in mid-air like high-tech resurrections from the murky depths of this Byzantine water tank. Not all the installations show such a strong imagination, and if an overall judgment has to be made, the artistic quality of the Biennial as a whole is mixed. But the experience of walking in and out of history is exhilarating by itself, and well worth the trip for its own sake.

Yuko Hasegawa, the 2001 curator, has just the right cross-cultural background. Raised a Zen Buddhist in Kyoto, she grew up amid respect for tradition. In Tokyo, she became a contemporary art curator before leaving for New York to work at the Whitney Museum of American Art. Her husband is a neuroscientist and she herself is interested in art's overlaps with science and psychology. As the bath-house indicates, her guiding idea for this year's Biennial is to treat looking at art as a shared rather than a one-on-one

encounter.

She describes her approach with an unabashed slogan of her own: “I want to replace the three Ms of the 20th century with the three Cs of the 21st.” Her three Ms are men, monetarism and materialism, which, she believes, have led in western society to an over-emphasis on the individual. Her three Cs are collective intelligence, collective consciousness and co-existence. We need these, she thinks, to survive and prosper henceforth. Although she could not have predicted it, her words had unexpected resonance at the show in the week after September 11th, when it opened. Everyone from taxi drivers and waiters to street vendors and artists were bursting with a need to share their thoughts and news about that tragic day.

In artistic terms, Ms Hasegawa's insistence on collective experience is more than a catchphrase. She has chosen artworks which link us to a world beyond our familiar lives and which act as a bridge between different cultures. For example, Francis Alys, a Mexico-based artist, presents a slide-show installation called “Sleepers”, where you sit on a sofa filled with Turkish cushions watching images of people and dogs snoozing in the streets of Mexico city, shot at sidewalk level, as though at your feet. A Colombian art group, Cambalache Collective, take a magic-bus approach. They drive around town in what they call a street museum—a commandeered bus—offering free rides in exchange for a small item of personal value, a pack of cigarettes, a hairclip or a photo. Cambalache then display these offerings jumble-sale style on a terrace of the mint. The message is that we can personalise humdrum, everyday transactions by reminding ourselves of their emotional connections.

Only connect

For Cambalache, and for many of the artists in this Biennial, art is more a means of communication than a form of self-expression. In the Hagia Eirene church, you can see the direct and colourful drawings of an octogenarian artist from Côte d'Ivoire, Frédéric Bruly Bouabré. He has invented an alphabet of over 400 pictograms to translate the oral history of his tribe, the Bete. In an overgrown courtyard of the imperial mint hang the wooden carvings of one of the most interesting artists in the show, an aboriginal sculptor, Du Weng Sig, who has never left his native Taiwan. He lives in the fog-shrouded mountains to the south and carves his pieces, which he says reflect his ancestors' spirits, out of the materials he finds there. Rather than sell his art, he gives it to friends on important occasions—a birth or the building of a new house, say—as a token for the transmission of good spirits.

To begin with Ms Hasegawa looked for Turkish art to put in her show. But she soon found that most young Turkish artists are more interested in shooting photographs and videos than in working with such traditional materials as textiles, carpets and ceramics. One Biennial artist who marries both traditions, Hussein Chalayan, is better known in Europe as an avant-garde fashion designer. A Turkish Cypriot based in London, Chalayan makes wearable art out of air-letters and kites; in his fashion-show-plus-performance-art pieces, models arrange themselves as bits of furniture, transforming into skirts and dresses as they move. He is interested in clothes as mutable materials that communicate ideas. And although his first label, perhaps unsurprisingly, went bankrupt, he will be making his mark in London this season. His work is on display at the Victoria & Albert Museum's “Radical Fashion” exhibition (until January 6th 2002), and Asprey, London's grandest luxury shop, has just made him creative director.

The single most charming work in the entire Biennial draws its inspiration from the rapid growth of this metropolis, already numbering more than 12m people. When a baby is born in Istanbul's big maternity hospital, the new parents can press a button triggering a meteoric burst of light on the bridge over the Bosphorus that links Asia and Europe. For its Italian creator, Alberto Garutti, this light piece, activated on average of 70 times a day, is a way for people across the city to celebrate life itself. It is a reminder also that this city of mosques is a place of modernity.

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Fiction from Turkey

Ataturk's children

Oct 25th 2001
From The Economist print edition

My Name is Red.
By Orhan Pamuk.
Knopf; 438 pages; $25.95. Faber and Faber; £10.99

Dear Shameless Death.
By Latife Tekin.
Marion Boyars; 237 pages; $14.95 and £8.99

“TO GOD belongs the East and the West,” one of Orhan Pamuk's characters declares, quoting the Koran. Another replies: “But East is East and West is West.” As this is Istanbul and 1591, the Kipling quotation is wonderfully anachronistic; penned by Mr Pamuk, a paid-up post-modernist with an impish sense of humour, the anachronism is certainly deliberate.

It is an enlightening, though eerie, experience to read this book at the present moment. For its theme is a clash of cultures—between a religious tradition which subordinates man to God, and a new-fangled individualism which places man at the centre of the universe. For the band of Ottoman miniaturists in Mr Pamuk's novel, the dilemma is first and foremost an artistic one. And at this level the book is above all a tribute to those who suffer, and make others suffer, for their art.

The Ottoman Istanbul, which Mr Pamuk depicts with skill and linguistic energy, is a rich, cruel and claustrophobic world where art leads, through dark alleyways, to murder. But the novel is also about the conflicts of Turkishness, about the push and pull of tradition and modernity, about a society caught between religious zealotry and an authoritarian state—themes as relevant to Turkey now as they were 400 years ago.

Modern Turkey's founder, Mustafa Kemal Ataturk, imposed a mix of nationalism and secularism on the country. He wanted Turks to turn their backs on the Ottoman past and become modern by imitating Europe. Yet Turks like Mr Pamuk—post-Kemalist as well as post-modern—are daring to disobey him, rediscovering and reinventing their Ottoman and Islamic inheritance, and finding a strange image of themselves in history's mirror.

Latife Tekin, too, is a disobedient child of Ataturk. To some critics, “Dear Shameless Death”, first published in Turkey in 1983, was not a novel at all. It confronted them with a world which they, like Ataturk, either ignored or looked down on—the world of the Anatolian village. The book is about the village where Ms Tekin herself had been born and which she left at the age of nine, when her family migrated to Istanbul. Other critics, dazzled by the book's originality and its interweaving of songs and rhymes and folk stories, spoke of the arrival of magic realism in Turkish fiction. If so, it is an everyday magic. For Ms Tekin, the jinns—sprites which take human or animal form—are as real as the rocks and trees and people of her village.

The moment when young Dermit (Ms Tekin's fictional alter ego) leaves the village is a moment of cosmic upheaval. “The dirt suddenly burnt beneath her feet, and the sky ripped apart at the centre. Rocks cracked open, weeds blazed and the scarecrows in the fields toppled over.” As she flees screaming, she stirs the anger of one of the jinns who picks her up and flings her among the bound-up mattresses in her father's truck. The panic-stricken child leaves her home with the angry music of the jinns beating in her ears.

Ms Tekin is less well known outside Turkey than Mr Pamuk. Only “Berji Kristin: Tales from the Garbage Hills” (Marion Boyars, 1996), which gives voice to a community of shantytown-dwellers, has previously been translated into English. It had wide acclaim (like Mr Pamuk, she has been well served by her

translators). Now this tardy but excellent edition of the 1983 novel ought to confirm her among English readers as one of the most original of the young Turks who are transforming their country's fiction.

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About sponsorship

Wall Street crash

Parallel bars

Oct 25th 2001
From The Economist print edition

Rainbow's End: The Crash of 1929.
By Maury Klein.
Oxford University Press; 368 pages; $27.50 and £22.99

LOOKING for parallels in history is usually a disappointment. Circumstances change, and nothing ever quite repeats. Even so, the search can offer useful lessons. Hence the consuming interest in the financial crash of 1929. It came at the end of a bull market that is uncannily reminiscent of the long 1990s boom, which was punctured last year.

Then, as now, there was talk of a new era, with electricity and the motor car playing the role of the Internet and the computer. Then, as now, commentators were on hand to explain why old valuation models needed to be changed. And then, as now, stockbrokers were consistently over-optimistic: price dips were seen as great buying opportunities, and brief rallies were hailed as the resumption of the inexorably upward bull market. Irving Fisher's statement on the eve of the crash that stocks had reached “a permanent high plateau” was only the most quoted of many such utterances.

As it happens, Maury Klein does not cite Fisher's quote, but otherwise he tells the story of the crash clearly and well, with some especially good pen portraits of characters such as Thomas Lamont, Jesse Livermore, Charley Mitchell and Albert Wiggin (who actually made money short-selling). Professor Klein is a historian and, as such, he makes little effort to explain or analyse the underlying economic causes of either the crash or the depression that followed it. The most he offers is the view that the crash was “a perfect storm”—a concatenation of disparate events that produced the single cataclysm.

Or rather, not single at all, as Professor Klein rightly points out. Although popular focus has always been on October 29th 1929, the market actually fell by only some 13% that day. The bigger 40% fall was spread over four weeks, and even then a lot of that was clawed back in early 1930. Only in 1932 did the market hit bottom, and it took until 1954 before equities regained their 1929 peaks. The truth is that the real damage to confidence comes not from a one-day fall, as in October 1987, but from a multi-year bear market of the kind we could be entering today.

Yet even a long bear market need not lead to a depression. Indeed, nobody has ever established a clear and conclusive link between the events of October 1929 and the 1930s depression. The latter was caused by wrong-headed monetary and fiscal policy, combined with the Smoot-Hawley tariffs, and not by happenings on Wall Street. That, too, is a lesson to heed.

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About sponsorship

The foundations of science

This side up

Oct 25th 2001
From The Economist print edition

Facing Up: Science and Its Cultural Adversaries.
By Steven Weinberg.
Harvard University Press; 304 pages; $26 and £17.95

Emergence: The Connected Lives of Ants, Brains, Cities and Software.
By Steven Johnson.
Scribner; 288 pages; $25. Allen Lane, The Penguin Press; £14.99

DOES particle physics have a unique claim to be regarded as the most fundamental of the sciences, and the closest to the bedrock of truth? Steven Weinberg, a Nobel prize-winning physicist at the University of Texas, thinks it does. Furthermore, he believes that theorists are within striking distance of the bedrock itself, in the form of a final, unified theory of nature's particles and forces. This is a controversial position, and one that Mr Weinberg has had to defend on a number of fronts.

For a start, many scientists in other fields object to the idea that fundamental physics should be granted special status, not to mention stupendous quantities of research money, to search for ever more exotic new particles that, unlike a new medicine, say, are of no obvious use to anyone. Mr Weinberg disagrees. Judging such research by the yardstick of practicality is unreasonable, he argues. Its real significance is that it is the culmination of man's centuries-long quest to understand the universe in more and more fundamental terms. This view earns him further opprobrium from fellow scientists who accuse him of being a reductionist—a label he happily accepts.

But Mr Weinberg also has to defend his view of physics against the cultural-studies crowd, which objects that the claim of physics to priority, like all scientific claims, is socially constructed. Here we are well into science-wars territory, and Mr Weinberg responds with a counterblast: physics is making real progress, he says, and it is false that scientists cannot see beyond the conceptual framework or paradigm of the day. Indeed it is widely agreed, he points out, that the standard model of forces and particles that has been painstakingly built up over the past century is merely an incomplete approximation to an even grander and more accurate theory.

The essays in “Facing Up” are illuminating and entertaining. They range across many subjects where Mr Weinberg has points to make or turf to defend. There are excursions into quantum physics, cosmology, the history of science, and science's relationships with politics and religion.

Critics of the kind of reductionism favoured by physicists are perfectly correct that knowing about atomic nuclei is not a help in itself with humdrum but complex problems like weather-prediction. The behaviour of many real-world systems arises from the bottom up, through the interactions of enormous numbers of tiny elements. Such so-called emergent systems are extremely difficult to analyse because more is different, as Philip Anderson, a physicist, once put it in a celebrated attack on reductionism. Instead, it is easier to think of the weather in top-down terms such as warm and cold fronts, rather than individual molecules of gas.

In “Emergence”, a dizzying, dazzling romp through fields as disparate as urban planning, computer-game design, neurology and control theory, Steven Johnson argues that emergence is an idea that has been around for some time. His point, which emerges in a suitably bottom-up manner, is that researchers in these fields have all been grappling with the same problem: how microscopic interactions spontaneously give rise to macroscopic phenomena. What is new, says Mr Johnson, is that it is now possible to engineer systems that exploit emergence. The first such examples have already appeared in Internet recommendation systems and computer games. Programmers can, in effect, invent their own laws of nature, and see what emerges. Such bottom-up organisation will become increasingly widespread, Mr

Johnson believes, though he somewhat overstates his case. At least he and Mr Weinberg agree that sometimes the view from the bottom can be the most informative in understanding the bigger picture.

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About sponsorship

French politics

Opening shots

Oct 25th 2001
From The Economist print edition

Matignon, Rive Gauche: 1997-2001.
By Olivier Schrameck.
Seuil; 190 pages; euro 14

WHAT is the point of this book? Olivier Schrameck is a quintessential insider. His career stretches from the Ecole Nationale d'Administration and the Council of State to the Constitutional Council. For the past four years, he has directed the office of France's prime minister, Lionel Jospin. From perhaps the most influential civil servant in France, surely we could have expected a book of serious weight.

The first half is an unilluminating and self-promoting account of the daily workings of government. It is written with a tortured elegance that no ordinary person would affect. The second half is a eulogy to Mr Jospin and a denunciation of Jacques Chirac, a conservative president condemned, by his own decision to call an election in 1997, to cohabit with Mr Jospin's Socialist-led coalition. Cohabitation is bad enough, in Mr Schrameck's view, and Mr Chirac has made it worse.

The president, it is true, has sought advantage by proposing steps, for example a ban on feeding bone meal to cattle, that the government was intending to take anyway. As a result, Mr Schrameck complains, Matignon (the prime minister's office on the left bank of the Seine) has had to waste time resisting the efforts of the Elysée (the presidential palace on the right bank) to “trip up or at least put in difficulty” Mr Jospin and his programme to modernise France, be it for the future of Corsica or the reform of the electoral calendar.

Well, he would say that, wouldn't he? And the charge is less than shattering. The aim of this book is to hurt Mr Chirac seven months before he seeks re-election—most probably against Mr Jospin. The mistake is to have published it just when France is meant to be at war with terrorism and when the politicians on both banks of the Seine are expected to talk with one voice. The fact that Mr Schrameck wrote and published this book with Mr Jospin's permission speaks poorly of both.

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About sponsorship

Kenneth Tynan

Decidedly blue

Oct 25th 2001
From The Economist print edition

The Diaries of Kenneth Tynan.
Edited by John Lahr.
Bloomsbury; 448 pages; $32.95 and £25

IN DECEMBER 1974, six years before his death, Kenneth Tynan recalled that in his great days as a theatre critic he had a sign on his desk that read: “Be light, stinging, insolent and melancholy.” Tynan's *Observer* reviews in the 1950s and 1960s were in that style, but to theatregoers with more radical tastes, they were passionate and intelligent as well. In that same entry Tynan declares that he is no longer any of those things, except melancholy. This is the tone of his diary; it is loud with self-pity. It does not make pleasant or easy reading.

As an advocate of new drama and an opponent of censorship, Tynan ought to be remembered as one of the more benevolent dictators of English cultural taste after the second world war. Even his adoption of Brechtianism was defined by an ideological flamboyance that occasionally irritated but never bored. So why did he feel so sorry for himself? He diagnoses his condition by means of aphorisms: “I used to take Dexamyl to give me enough confidence to start work. Now I take it to give me enough confidence not to.”

He offers titles for an autobiography. If not “Sans Taste”, how about “Independently Blue”? His crueller asides become petty (“Lord Harlech's breath is seldom free from garlic”), and he repeats himself. He so likes the phrase, “One swallow does not make a slummer”, that he enters it in January 1972 and April 1973. The diaries are lightly edited by John Lahr, who says that among the few cuts he made were Tynan's remarks about Test cricket—a pity, because cricket was one of the few things he continued to enjoy.

He was a celebrity who never ceased to be a fan. On successive evenings, Tynan meets Princess Margaret (“we kiss, we chat, and she suggests we go in to dine”) and attends a rally for George Jackson, a radicalised young black Californian accused of killing a prison guard. Contradiction is at the heart of Tynan's darkness. Despite emphysema he must smoke. He loves his beautiful wife, Kathleen, but his confession of his own infidelity legitimises hers. He seeks sexual comfort with an out-of-work actress named Nicole, who shares his taste for spanking bottoms. Tynan is lyrical about this, though sometimes his exhaustive descriptions read like sexual fantasy.

By the 1970s his public reputation was marked by his production of an erotic review, “Oh! Calcutta!” In February 1976, in a leader headlined “The Pornography of Hatred”, the London *Times* wrote that Tynan had been corrupted by the pornography of cruelty and rape. The accusation was itself reckless, though it was perhaps the price Tynan paid for a style whose intention was to shock. The diaries give no indication of Tynan's spirited counter-offensive which led to the *Times* printing a correction and paying his legal costs.

As a record of his bravura style, the diaries are a poor account compared with the collected letters and with Kathleen Tynan's biography. He barely mentions a *New Yorker* series written towards the end of his life: long profiles of vivid characters he admired, such as Mel Brooks, Johnny Carson, Ralph Richardson and Tom Stoppard. These are among Tynan's best work, and they demolish another of his aphorisms: “There are writers who have written themselves out at 40; and there are writers who have written themselves in. There is no third kind.” Tynan was 26 when he became the *Observer*'s critic in 1953 and 50 when he wrote the first of these *New Yorker* profiles. They were published as “Show People” and are a far more eloquent epitaph than these diaries.

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About sponsorship

New fiction

More sinned against

Oct 25th 2001
From The Economist print edition

RICHARD FORD'S characters are often introduced with a career résumé that charts their progress from, say, a Nebraska childhood, through an MBA, to the Upper East Side. We see them from the outside, their powder-blue ski suits and expensive Italian overcoats in olive green becoming a symbol of their social status. But do we really get to see inside their minds?

Only sometimes. In one of the better stories, Faith, a Hollywood lawyer, takes her mother, her brother-in-law and her two nieces on a Christmas skiing holiday in Michigan, while her prodigal sister is in rehab. The mother is an obese mountain of passivity, the sister's estranged husband is a lech, the children are insecure, and Faith's efforts to cheer them up by dressing the plastic rubber plant with seasonal fairylights has a surreal hollowness. Although we see things through Faith's eyes, she is a character with enough depth to have mixed motives, her generosity compromised by her sense of her own superiority and her attempts to rewrite family history.

Other characters, often the female ones, fare less well. One woman is introduced as a pretty little airhead with no character of any sort. This seems like a cop-out, and a faintly misogynist one at that. In those stories which pivot on a narrative twist the characters often seem no more than functional elements in a predetermined plot. When you think of great short story writers—Chekhov, Katherine Mansfield, Saul Bellow—and how they manage to get so much into such little space, this collection is sadly disappointing. Richard Ford has written far better stories than these.

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About sponsorship

Chang Hsueh-liang

Oct 25th 2001
From The Economist print edition

Chang Hsueh-liang, a Chinese enigma, died on October 14th, aged 101

Corbis

SOME writers about China believe that Chang Hsueh-liang changed the course of modern Chinese history, and indeed of the world. This is what happened.

In the 1930s three armies competed for possession of China, those of the Nationalist government, the Communists and the Japanese. Mr Chang was unsure where his best interests lay. He was a “warlord”, one of China's numerous local despots who gave tacit support to the Nationalists. His fief, inherited from his father, a bandit who created one of China's most ferocious fighting forces, was Manchuria, a territory the size of Western Europe.

The Japanese successfully invaded Manchuria in 1931 deploying their superior arms and a ruthlessness that exceeded even that of Mr Chang's army. They hoped to woo him to their side, as they had Pu Yi, the “last emperor”. The story goes that Mr Chang discussed Japan's seemingly generous terms with two of his commanders who were in favour of accepting them, but he preferred to stay with the Nationalists. He ended the discussion with his commanders by shooting them dead.

The Communists had more success with Mr Chang. He was approached by Zhou Enlai, whose silky tongue was already charming westerners who visited the Communist camp. Why were the Nationalists and the Communists fighting each other, he asked, when their common enemy was Japan? It may be that Mr Chang was already thinking along the same lines. But how to convince the Nationalist leader, Chiang Kai-shek?

Direct action was Mr Chang's way. In December 1936 his soldiers stormed a building in Xian where Chiang was staying and took him prisoner, roughing him up in the process. “Please don't be angry,” said Mr Chang who prided himself on being a gentleman. “I wish to lay my views before your excellency.” Chiang Kai-shek, who probably expected to be killed, found his captor's views convincing. Two weeks later when he was released the Nationalists and the Communists formed a united front against the Japanese. The deal greatly benefited the Communists, who had lost many thousands of followers in their “long march” to escape the Nationalist forces. But for Mr Chang's intervention, so it is argued, they might never have recovered sufficiently to win power in 1949.

A time of revenge

Some historians are puzzled why Chiang Kai-shek, once freed, did not break his promise to unite with the Communists, which had been made under duress. But there were other pressures on him. The United States and Britain, Chiang's main suppliers of arms, were leaning on him to fight the Japanese more enthusiastically. Whatever the reason for his surrender, he took revenge on his captor. Mr Chang volunteered to appear before a Nationalist court, expecting no more than a reprimand. Instead he was placed under “stringent supervision”. When the Nationalists fled to Taiwan after the Communist victory they took Mr Chang with them.

He was their prisoner for 54 years, until 1990. Would Mr Chang have done better to have thrown in his lot with the Communists? Hard to say. He had had an American tutor for much of his boyhood, and developed a taste for western pleasures such as fast cars. He flew his own aircraft and played poker for ridiculous stakes. In 1933 he had taken a long leave from his army duties, most of it spent in Europe.

Gossipy newspapers recorded his social success. Mr Chang was, they said, equally brilliant on the polo field and in the ballroom. And handsome too: he was said to have had an affair with a daughter of Mussolini. The Italian dictator briefed him on the merits of fascism, which Mr Chang thought might be suitable for China. Before returning to China he placed his four children in English private schools. It is difficult to imagine him having much in common with Chairman Mao.

In Taiwan he was allowed rather more freedom than most political prisoners. He had a large house with servants in a suburb of Taipei. One of his several wives lived with him throughout his imprisonment. All the same, incarceration for that length of time, however comfortable, would be more than most people could bear. Seemingly, he made no attempt to escape. At his trial he had said he regretted his “impudent and criminal act” and it may be that his feeling of guilt persisted throughout his life. When Chiang Kai-shek died in 1975, many in Taiwan thought Mr Chang should be forgiven. In 1987 when Taiwan started to toy with democracy, there were renewed calls to release him. When freedom was finally granted to Mr Chang in 1990 it was assumed he would stay on in his Taipei home, and continue his studies of Chinese history, which had been his main occupation. But he wanted to see the United States, an ambition kindled long ago by his tutor. In 1995 he moved to Hawaii and there he spent the last six years of his life.

In China, Chang Hsueh-liang (or Zhang Xueliang in the modern romanised spelling) remains a Communist hero. Xinhua, the government's news agency, used the occasion of his death to say thank-you to the man who gave the exhausted Communists a breathing space. He is remembered, the agency said, “as a great patriot in contemporary China”.

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Overview

Oct 25th 2001
From The Economist print edition

Initial jobless claims in **America** rose by 24,000 to 491,000 (on a four-week moving-average basis), the highest level for more than ten years. The number of people continuing to receive unemployment benefits rose to an 18-year high. Trade figures for August showed imports falling to $111.6 billion, their lowest level since January 2000, while the merchandise trade deficit fell to $33.8 billion from $35.8 billion in July. Consumer–price inflation slowed slightly, to 2.6% in the year to September, in line with analysts' expectations.

Germany's Ifo business confidence index plunged from 89.5 in August to 85.0 in September, falling well below forecasts. The index now stands at its lowest level for nearly eight years. The German government lowered its forecast for GDP growth this year to 0.75% from 2%. Other German data was mixed. Revised figures showed that industrial output rose by 2.2% in August, but it was still down by 1.0% over the year. The 12-month rate of growth in wages increased to 1.9% in August, from 1.4% in July, yet real wages fell by 0.7%.

The **euro-zone** visible-trade surplus narrowed to $4.9 billion in August, but the 12-month surplus increased to $14.6 billion. France's current-account surplus grew to $20.3 billion in the same period.

Britain's exporters are bearing the brunt of the global slowdown. According to a survey by the Confederation of British Industry, 59% of manufacturers were less optimistic about their export prospects for the year ahead, a sharp downturn from the survey last quarter. Only 6% were more optimistic. This was the largest quarterly deterioration in expectations for 21 years.

Inflation slowed in **Canada**, to 2.6% in the year to September. Along with evidence that the economy is slowing faster than expected, this prompted the Bank of Canada to cut the target for its overnight interest rate from 3.5% to 2.75%. This brings the total drop in interest rates since the start of the year to three percentage points.

Australia's rate of consumer-price inflation fell to 2.5% in the year to the third quarter, from 6.0% in the second quarter. This was largely because last year's introduction of the Goods and Services Tax dropped out of the year-on-year calculation.

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Output, demand and jobs

Oct 25th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	latest	latest	latest	year ago
Australia	+ 3.6	+ 1.4 Q2	+ 2.3	+ 3.5	– 0.4 Q2	+ 0.7 Q2	6.7 Sep	6.0
Austria	+ 0.2	+ 1.2 Q2	+ 1.6	+ 1.6	+ 4.6 Jul	– 0.2 Jun	3.9 Sep	3.6
Belgium	– 2.4	+ 1.7 Q2	+ 1.6	+ 1.6	– 2.6 Aug*	– 5.0 Jul	11.6 Aug*	11.9
Britain	+ 1.7	+ 2.3 Q2	+ 2.0	+ 1.9	– 2.3 Aug	+ 5.9 Sep	5.1 Aug†	5.3
Canada	+ 0.4	+ 2.1 Q2	+ 1.6	+ 1.8	– 3.6 Jul**	+ 3.5 Jun	7.2 Sep	6.9
Denmark	+ 2.4	+ 1.3 Q2	+ 1.2	+ 1.8	+ 0.8 Aug	– 0.5 Aug	5.1 Aug	5.4
France	+ 1.1	+ 2.3 Q2	+ 1.9	+ 1.6	+ 1.5 Aug	+ 0.6 Aug	9.0 Aug	9.5
Germany	– 0.1	+ 0.6 Q2	+ 0.8	+ 1.2	– 1.0 Aug	+ 0.4 Aug	9.4 Sep	9.4
Italy	+ 0.1	+ 2.1 Q2	+ 1.8	+ 1.5	– 1.6 Aug	– 1.5 Jul	9.4 Jul	10.5
Japan	– 3.2	– 0.7 Q2	– 0.5	– 0.4	–11.7 Aug	– 2.1 Jun	5.0 Aug	4.6
Netherlands	+ 1.5	+ 1.4 Q2	+ 1.4	+ 1.8	– 2.2 Aug	+ 2.7 Jun	2.0 Sep§	2.5
Spain	+ 1.9	+ 2.9 Q2	+ 2.7	+ 2.2	+ 2.8 Aug	na	13.0 Aug	13.9
Sweden	+ 1.3	+ 1.4 Q2	+ 1.8	+ 2.0	– 2.6 Jun	+ 3.0 Aug	4.0 Sep*	4.1
Switzerland	+ 1.7	+ 2.0 Q2	+ 1.6	+ 1.6	+ 4.2 Q2*	+ 3.6 Aug	1.7 Sep*	1.7
United States	+ 0.3	+ 1.2 Q2	+ 1.0	+ 1.0	– 5.8 Sep	+ 4.3 Aug	4.9 Sep	3.9
Euro area	+ 0.2	+ 1.7 Q2	+ 1.6	+ 1.5	+ 0.4 Aug	+ 1.3 Jul	8.3 Aug	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 6.7	+ 0.4 Q2	na	na	– 1.9 Aug	+ 6.8 Jun	8.7 Sep*	9.1
Greece	+ 2.8	+ 4.9 Q2	na	na	+ 1.0 Jun*	+ 8.0 Jun	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.2 Jul	1.3
Ireland	na	+13.2 Q1	na	na	+ 0.1 Aug*	+ 6.2 Jul	3.7 Sep	3.8
Luxembourg	na	+ 8.52000	na	na	+ 2.7 Jul*	+ 8.2 Jul	2.4 Aug	2.7
New Zealand	+ 7.4	+ 2.8 Q2	na	na	+ 3.5 Q2*	+ 7.2 Q2	5.2 Q2	6.1
Norway	+ 0.5	+ 1.4 Q2	na	na	+ 0.9 Aug*	0.0 Sep	3.6 Q2	3.3
Portugal	– 0.3	+ 2.2 Q1	na	na	– 1.2 Aug*	+ 5.2 Jul	3.9 Q2	3.8

*Not seasonally adjusted. † Jun-Aug; claimant count rate 3.1% inSep. §Jul-Sep. **New series.

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Prices and wages

Oct 25th 2001
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.5	Q3	+ 6.0	+ 4.0	+ 2.5	+ 2.4	Q3	+ 7.2	+ 3.7	Q2	+ 3.9
Austria	+ 2.6	Sep	+ 3.0	+ 2.5	+ 1.6	+ 0.1	Sep	+ 6.2	+ 2.8	Aug	+ 1.9
Belgium	+ 2.3	Sep	+ 3.4	+ 2.6	+ 1.7	+ 0.7	Aug	+ 9.2	+ 2.6	Q2	+ 2.2
Britain	+ 1.7	Sep	+ 3.3	+ 2.0	+ 2.1	− 0.2	Sep	+ 2.5	+ 4.5	Aug	+ 4.0
Canada	+ 2.6	Sep	+ 2.7	+ 2.8	+ 2.0	+ 0.9	Aug	+ 3.9	+ 1.7	Jul	+ 1.1
Denmark	+ 2.3	Sep	+ 2.7	+ 2.4	+ 2.0	+ 0.7	Sep	+ 6.9	+ 4.7	Q2	+ 3.3
France	+ 1.6	Sep	+ 2.2	+ 1.9	+ 1.5	+ 0.7	Aug	+ 5.8	+ 4.2	Q2	+ 5.4
Germany	+ 2.1	Sep	+ 2.5	+ 2.4	+ 1.4	− 0.2	Sep	+ 7.2	+ 1.9	Aug*	+ 2.1
Italy	+ 2.6	Sep	+ 2.6	+ 2.7	+ 1.8	+ 1.2	Aug	+ 6.5	+ 2.5	Aug*	+ 1.8
Japan	− 0.7	Aug	− 0.5	− 0.6	− 0.6	− 0.2	Sep	+ 0.4	− 4.1	Aug*	+ 2.0
Netherlands	+ 4.7	Sep	+ 2.9	+ 4.7	+ 2.2	+ 1.9	Aug	+ 7.8	+ 4.3	Aug	+ 3.3
Spain	+ 3.4	Sep	+ 3.7	+ 3.7	+ 2.4	+ 1.6	Aug	+ 5.1	+ 2.9	Q2†	na
Sweden	+ 3.2	Sep	+ 1.3	+ 2.3	+ 1.8	+ 1.1	Sep	+ 3.7	+ 1.9	Jul*	+ 4.0
Switzerland	+ 0.7	Sep	+ 1.4	+ 1.3	+ 1.1	− 0.9	Sep	+ 2.8	+ 1.3	2000	+ 0.3
United States	+ 2.6	Sep	+ 3.5	+ 3.1	+ 2.1	+ 1.6	Sep	+ 3.5	+ 4.3	Sep	+ 3.7
Euro area	+ 2.5	Sep	+ 2.8	+ 2.6	+ 1.7	+ 1.7	Aug	+ 5.6	+ 3.0	Q2	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.2	Sep	+ 4.2	na	na	− 2.1	Sep	+ 9.6	+ 4.8	Q2*	+ 4.6
Greece	+ 3.6	Sep	+ 3.1	na	na	+ 3.1	Aug	+ 7.9	na		na
Iceland	+ 8.0	Oct	+ 4.2	na	na	+ 6.8	Oct	+ 3.6	+ 9.1	Sep	+ 7.8
Ireland	+ 4.6	Sep	+ 6.2	na	na	+ 2.6	Sep	+ 6.4	+ 8.1	Q1*	+ 6.1
Luxembourg	+ 2.4	Sep	+ 3.4	na	na	− 0.4	Aug	+ 6.9	+ 5.2	Jul*	+ 8.1
New Zealand	+ 2.4	Q3	+ 3.0	na	na	+ 8.1	Q2	+ 5.9	+ 1.8	Q2	+ 1.7
Norway	+ 2.4	Sep	+ 3.5	na	na	−11.0	Sep	+ 7.4	+ 4.4	Q2*	+ 3.9
Portugal	+ 4.0	Sep	+ 3.4	na	na	− 0.2	Aug	+14.2	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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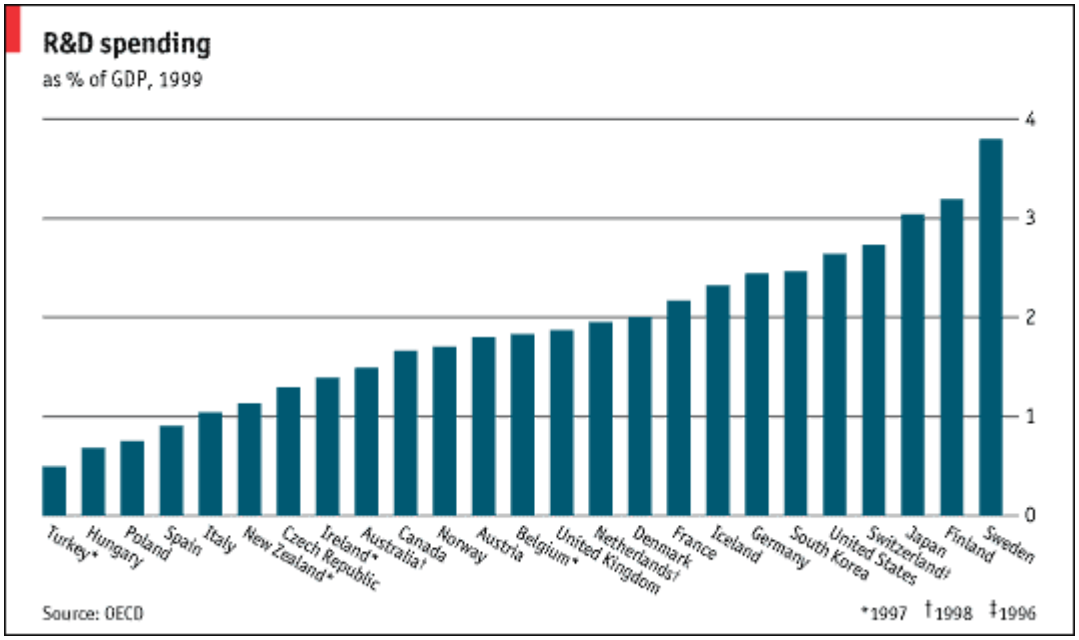
R&D spending

Oct 25th 2001
From The Economist print edition



In 1999, 2.2% of OECD countries' total GDP was spent on research and development. Between 1981 and 1999, R&D spending grew by 4% a year, accelerating in the second half of the 1990s. In those years R&D intensity (ie, spending relative to GDP) was stable in Europe, but rose in America and Japan. America's increase, however, stemmed from an acceleration of research expenditure, while Japan's reflected flagging GDP growth.

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Money and interest rates

Oct 25th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 24th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+14.7	+ 7.7	Aug	4.35	6.36	4.19	5.50	5.98	4.52
Britain	+ 6.3	+ 8.0	Sep	4.31	6.06	4.34	4.68	5.16	6.07
Canada	+10.4	+ 4.5	Sep	2.53	5.62	3.22	5.20	5.71	7.08
Denmark	+ 6.7	+ 2.3	Aug	3.83	5.46	3.89	4.75	5.48	6.94
Japan	+11.8	+ 3.7	Sep	0.01	0.45	0.06	1.32	1.82	1.40
Sweden	+ 5.9	+ 3.1	Sep	3.68	3.93	4.00	5.06	5.10	5.07
Switzerland	+ 1.7	+ 3.2	Sep	2.21	3.50	2.27	2.96	3.83	4.12
United States	+ 7.5	+11.9	Sep	2.22	6.50	2.70	4.59	5.68	6.82
Euro area†	+ 3.1	+ 6.6	Aug	3.58	5.16	3.33	4.51	5.18	5.40

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.33%, Japan No.234 1.33%. Central bank rates: US fed funds 2.50%, ECB refinancing 3.75%, BOJ overnight call 0.001%, BOE repo 4.50%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 25th 2001
From The Economist print edition

1995=100

	Oct 16th	Oct 23rd*	% change on one month	% change on one year
Dollar index				
All items	62.8	62.3	– 4.1	–13.0
Food	65.2	65.1	– 3.1	– 7.7
Industrials				
All	59.5	58.5	– 5.7	–20.0
Nfa†	55.8	55.1	– 8.6	–17.5
Metals	62.6	61.4	– 3.5	–21.9
Sterling index				
All items	68.4	69.2	– 0.8	–11.3
Euro index				
All items	90.8	92.2	– 0.3	–18.0
Yen index				
All items	81.0	81.5	+ 0.4	– 1.0
Gold				
$ per oz	282.35	275.80	– 4.7	+ 2.0
West Texas Intermediate				
$ per barrel	22.30	21.62	– 0.9	–35.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 25th 2001
From The Economist print edition

Market indices

	Oct 24th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,182.1	3,425.2	2,867.4	+ 0.4	– 7.1	+ 0.9	– 7.7
Austria (ATX)	1,041.1	1,245.8	1,041.1	– 4.6	–40.1	– 3.0	– 7.8
Belgium (Bel 20)	2,643.4	3,030.4	2,322.6	+ 1.4	–28.2	–12.6	–16.9
Britain (FTSE 100)	5,167.6	6,334.5	4,433.7	– 0.7	–25.4	–17.0	–20.9
Canada (Toronto Composite)	6,896.9	9,348.4	6,513.1	– 0.9	–39.4	–22.8	–26.3
Denmark (KBX)	223.6	294.3	197.8	+ 0.4	–25.9	–15.5	–19.4
France (SBF 250)	2,860.1	3,820.2	2,335.3	+ 1.8	–34.9	–24.2	–27.9
(CAC 40)	4,486.4	5,998.5	3,652.9	+ 1.7	–35.2	–24.3	–28.1
Germany (Xetra DAX)	4,811.8	6,795.1	3,787.2	+ 3.6	–40.3	–25.2	–28.9
Italy (BCI)	1,403.8	1,948.4	1,082.9	+ 2.4	–35.7	–26.7	–30.4
Japan (Nikkei 225)	10,802.2	14,529.4	9,504.4	+ 0.4	–72.2	–21.6	–27.2
(Topix)	1,100.2	1,441.0	863.4	+ 1.2	–61.9	–14.3	–20.4
Netherlands (AEX)	468.0	642.3	396.2	+ 0.9	–33.3	–26.6	–30.2
Spain (Madrid SE)	794.0	963.9	648.6	+ 1.8	–30.7	– 9.8	–14.3
Sweden (Affarsvarlden Gen)	209.0	293.1	177.5	– 0.9	–47.8	–24.7	–33.1
Switzerland (Swiss Market)	6,279.4	8,135.4	5,110.2	+ 4.2	–25.4	–22.8	–24.7
United States (DJIA)	9,345.6	11,337.9	8,235.8	+ 1.2	–20.3	–13.4	–13.4
(S&P 500)	1,085.2	1,373.7	965.8	+ 0.8	–29.0	–17.8	–17.8
(Nasdaq Comp)	1,731.5	2,859.2	1,423.2	+ 5.2	–65.7	–29.9	–29.9
Europe (FTSE Eurotop 300)*	1,207.4	1,545.5	998.9	+ 1.0	–29.2	–21.3	–25.2
Euro area (FTSE Ebloc 100)*	1,054.0	1,404.1	843.6	+ 2.1	–32.0	–24.3	–28.0
World (MSCI)†	966.7	1,249.2	856.6	+ 0.1	–33.3	na	–20.8
World bond market (Salomon)‡	450.3	458.1	420.6	– 0.9	– 2.1	na	+ 1.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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About sponsorship

Trade, exchange rates and budgets

Oct 25th 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Oct 24th	Exchange rate trade-weighted† year ago	Currency units per $ Oct 24th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	+ 1.5 Aug	− 9.9 Q2	− 2.9	− 3.2	71.3	71.0	1.97	1.93	2.85	1.79	1.62	0.1
Austria	− 5.2 Jul	− 4.2 Aug	− 2.6	− 2.5	100.2	98.4	15.4	16.6	22.3	14.0	12.7	-0.6
Belgium	+ 11.7 Aug	+ 8.9 Jun	+ 4.1	+ 4.3	99.0	96.6	45.2	48.7	65.4	41.1	37.3	0.7
Britain	− 47.4 Aug	− 19.2 Q2	− 1.9	− 2.4	104.9	110.4	0.70	0.70	–	0.64	0.58	1.2
Canada	+ 46.2 Aug	+ 25.5 Q2	+ 2.6	+ 1.9	76.4	79.0	1.57	1.52	2.28	1.43	1.30	2.6
Denmark	+ 7.0 Aug	+ 6.0 Aug	+ 1.8	+ 1.7	102.6	98.7	8.33	8.98	12.1	7.57	6.87	2.9
France	+ 2.0 Aug	+ 20.3 Aug	+ 1.5	+ 1.5	101.6	98.9	7.35	7.92	10.6	6.68	6.06	-0.5
Germany	+ 64.1 Aug	− 18.8 Aug	− 1.0	− 0.9	98.6	95.2	2.19	2.36	3.17	1.99	1.81	-1.7
Italy	+ 3.0 Aug	− 1.5 Jul	− 0.3	− 0.2	72.5	70.6	2,170	2,337	3,141	1,972	1,790	-1.3
Japan	+ 81.0 Aug	+ 89.3 Aug	+ 2.0	+ 1.9	137.4	160.3	123	108	178	112	–	-6.3
Netherlands	+ 18.7 Aug	+ 13.7 Q2	+ 4.0	+ 4.1	98.0	95.1	2.47	2.66	3.57	2.24	2.04	1.3
Spain	− 38.3 Jul	− 16.6 Jul	− 2.7	− 2.7	74.2	72.5	186	201	270	169	154	nil
Sweden	+ 12.1 Aug	+ 6.1 Aug	+ 1.9	+ 2.1	73.8	80.1	10.61	10.22	15.4	9.64	8.75	3.6
Switzerland	+ 0.3 Sep	+ 27.0 Q2	+10.6	+10.5	111.4	106.7	1.66	1.81	2.40	1.51	1.37	na
United States	−448.0 Aug	−449.9 Q2	− 4.2	− 4.0	119.6	116.6	–	–	1.45	0.91	0.82	2.1
Euro area	+ 14.6 Aug	− 29.4 Jul	− 0.3	− 0.2	78.9	73.5	1.12	1.21	1.62	–	0.92	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.5 Aug	+ 8.4 Aug	na	na	78.5	75.0	6.66	7.18	9.64	6.06	5.50	5.3
Greece	− 7.4 Jun	− 7.3 Jun	na	na	57.5	56.3	382	410	553	347	315	nil
Iceland	− 0.3 Aug	− 0.9 Q1	na	na	na	na	105	87.2	152	95.2	86.4	2.4
Ireland	+ 30.3 Jul	− 1.5 Q2	na	na	87.6	83.3	0.88	0.95	1.28	0.80	0.73	4.5
Luxembourg	− 3.1 Jul	+ 1.2 Q2	na	na	99.0	96.6	45.2	48.7	65.4	41.1	37.3	3.6
New Zealand	+ 0.1 Aug	− 1.9 Q2	na	na	80.1	74.1	2.39	2.51	3.46	2.17	1.97	1.0
Norway	+ 27.3 Sep	+ 26.0 Aug	na	na	96.9	92.6	8.91	9.57	12.9	8.10	7.35	15.3
Portugal	− 13.8 Jul	− 9.1 Aug	na	na	89.4	87.4	225	242	325	204	185	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

Text refers only to the first 16 countries listed

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About sponsorship

Share prices by sector

Oct 25th 2001
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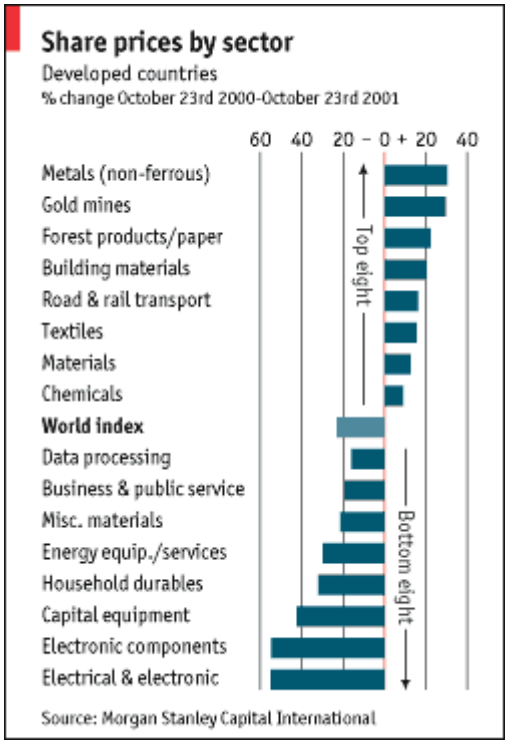

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Overview

Oct 25th 2001
From The Economist print edition

The news from **Argentina** remains grim. Industrial production fell by 7.1% in the year to September. A recent Reuters poll shows disagreement between domestic and American investment analysts on whether Argentina will default on its foreign debt this year. Only 13% of the Argentines predict an imminent default while the Americans put the probability at nearly even odds (47%).

China's stockmarket soared by 4.6% over the past week, with a little help from the government. It announced a suspension in sales of government-held shares, which, in effect, shut off the supply of new equity. Chinese shares had fallen by 30% since July, when Beijing said that it would not intervene to support prices. The latest policy shift casts doubt on the country's commitment to market reforms.

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Sovereign ratings

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Plagued by economic crisis, Argentina has seen a dramatic worsening in its credit-rating over the past year. On October 9th, Standard & Poor's rating agency lowered its rating of Argentina's long-term foreign-currency debt to CCC+. Among the emerging economies in the table, only Indonesia has such a low rating. Brazil's credit rating has also fallen sharply, from B+ two years ago, to BB-.

Sovereign ratings

Long-term foreign-currency credit ratings

	Oct-99	Oct-01
Argentina	BB	CCC+
Indonesia	CCC+	CCC+
Turkey	B	B-
Russia	SD*	B
Venezuela	B+	B
Brazil	B+	BB-
Peru	BB	BB-
Colombia	BB+	BB
India	BB	BB
Mexico	BB	BB+
Philippines	BB+	BB+
Egypt	BBB-	BBB-
South Africa	BB+	BBB-
Thailand	BBB-	BBB-
China	BBB	BBB
Malaysia	BBB-	BBB
South Korea	BBB-	BBB
Poland	BBB	BBB+
Chile	A-	A-
Czech Republic	A-	A-
Hungary	BBB	A-
Israel	A-	A-
Hong Kong	A	A+
Taiwan	AA+	AA
Singapore	AAA	AAA

Source: Standard & Poor's *Selective default

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Economy

Oct 25th 2001
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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 9.5	Sep	– 0.1	Sep	+18.6	Sep	+20.5	2000	187.5	Jul
Hong Kong	+ 0.5	Q2	– 0.1	Q2	– 1.2	Sep	–12.0	Aug	+ 8.2	Q2	113.4	Sep
India	+ 4.4	Q2	+ 1.8	Aug	+ 5.2	Aug	– 5.7	Aug	– 0.9	Q2	42.0	Sep
Indonesia	+ 3.5	Q2	+ 7.5	Q1	+13.0	Sep	+24.8	Aug	+ 6.3	Q1	27.8	Aug
Malaysia	+ 0.5	Q2	– 7.3	Aug	+ 1.4	Sep	+15.7	Aug	+ 7.5	Q2	26.9	Jul
Philippines	+ 3.3	Q2	– 2.1	Jul	+ 6.1	Sep	+ 3.7	Aug	+ 6.9	Jun	12.3	Jul
Singapore	– 5.6	Q3	–21.4	Aug	+ 0.5	Sep	+ 4.5	Sep	+22.6	Q2	74.0	Jul
South Korea	+ 2.7	Q2	– 4.7	Aug	+ 3.2	Sep	+11.5	Sep	+12.1	Aug	97.0	Jul
Taiwan	– 2.4	Q2	–14.1	Sep	– 0.5	Sep	+13.0	Sep	+14.1	Q2	115.2	Sep
Thailand	+ 1.9	Q2	+ 1.4	Aug	+ 1.4	Sep	+ 2.9	Aug	+ 6.7	Aug	32.6	Aug
Argentina	– 0.5	Q2	– 7.1	Sep	– 1.1	Sep	+ 3.4	Aug	– 8.4	Q2	14.4	Aug
Brazil	+ 0.8	Q2	nil	Aug	+ 7.3	Sep	– 0.1	Sep	–27.1	Aug	40.1	Sep
Chile	+ 3.4	Q2	+ 1.7	Aug	+ 3.9	Sep	+ 1.6	Sep	– 1.6	Q2	14.7	Aug
Colombia	+ 1.6	Q2	– 3.2	Aug	+ 8.0	Sep	+ 0.9	Jul	– 0.7	Q2	9.5	Jul
Mexico	nil	Q2	– 5.4	Aug	+ 6.1	Sep	– 9.5	Aug	–17.5	Q2	42.8	Sep
Peru	+ 0.7	Aug	– 3.3	Aug	+ 0.9	Sep	– 0.2	Aug	– 1.4	Q2	8.4	Sep
Venezuela	+ 2.9	Q2	na		+12.3	Sep	+15.6	Q2‡	+11.1	Q2	10.6	Jul
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.2	Jul	– 9.9	Q1	– 0.2	Q1	13.0	Jun
Israel	+ 1.4	Q2	– 5.8	Jul	+ 2.5	Sep	– 7.6	Sep	– 1.1	Q1	24.2	Sep
South Africa	+ 2.5	Q2	+ 0.6	Aug	+ 4.4	Sep	+ 4.3	Aug	+ 0.4	Q2	6.0	Aug
Turkey	– 9.3	Q2	–10.1	Aug	+61.8	Sep	–19.3	Jul	– 3.1	Jul	18.8	Aug
Czech Republic	+ 3.9	Q2	+ 3.0	Aug	+ 4.7	Sep	– 3.3	Sep	– 2.7	Q2	13.5	Sep
Hungary	+ 4.0	Q2	+ 1.4	Aug	+ 8.0	Sep	– 2.3	Aug	– 1.4	Aug	12.0	Aug
Poland	+ 0.9	Q2	– 3.8	Sep	+ 4.3	Sep	– 9.6	Aug	– 6.2	Aug	27.3	Sep
Russia	+ 5.1	Q2	+ 3.8	Sep	+20.1	Sep	+57.7	Aug	+44.6	Q2	34.0	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+10.2	Jun	+ 2.9	Sep	– 1.5	Jul	– 1.1	2001†	1.3	Jun
Saudi Arabia	+ 4.5	2000§	na		– 0.3	Jul	+50.9	2000	+15.6	2000	17.0	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Oct 25th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 24th		Dec 31st 2000	
	Oct 24th	year ago	Oct 24th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	1,792.6	+4.6	−18.2	−18.2
Hong Kong	7.80	7.80	11.1	2.25	10,243.5	−0.2	−32.1	−32.1
India	48.0	46.6	68.4	7.00	3,040.2	−0.1	−23.5	−25.6
Indonesia	10,230	8,955	14,560	17.96	386.0	+1.2	−7.3	−12.3
Malaysia	3.80	3.80	5.41	3.30	616.4	−0.8	−9.3	−9.3
Philippines	51.9	49.7	73.9	13.81	979.3	−6.1	−34.5	−36.9
Singapore	1.83	1.75	2.60	1.19	1,417.2	−1.7	−26.4	−30.3
South Korea	1,294	1,139	1,841	4.37	541.5	+2.5	+7.3	+4.9
Taiwan	34.5	32.0	49.1	2.90	3,986.7	+4.4	−16.0	−19.5
Thailand	44.8	43.6	63.7	3.00	284.1	−1.3	+5.5	+2.2
Argentina	1.00	1.00	1.42	32.00**	246.6	−2.0	−40.9	−40.9
Brazil	2.74	1.92	3.89	19.05	11,467.7	+1.9	−26.5	−47.6
Chile	713	576	1,014	2.78*	5,202.0	+1.6	+6.8	−14.0
Colombia	2,319	2,167	3,301	11.54	807.7	+3.6	na	na
Mexico	9.22	9.62	13.1	7.02	5,708.3	+3.0	+1.0	+5.3
Peru	3.45	3.51	4.9	5.04	1,159.2	+0.8	−4.1	−2.0
Venezuela	743	694	1,058	14.75	6,728.3	−0.3	−1.0	−6.7
Egypt	4.26	3.88	6.07	8.69	5,808.7	+1.3	−24.2	−30.8
Israel	4.31	4.15	6.14	4.47	379.4	+0.7	−23.3	−28.1
South Africa	9.38	7.66	13.3	9.12	8,583.4	−1.0	+3.1	−16.8
Turkey	1,612,500	687,490	2,295,071	57.00	9,578.2	+6.9	+1.5	−57.8
Czech Republic	37.4	42.0	53.2	5.24	368.0	+2.5	−23.1	−22.5
Hungary	283	317	403	10.76	6,604.3	+1.5	−15.9	−16.1
Poland	4.12	4.70	5.86	13.68	13,365.1	+1.8	−25.1	−24.9
Russia	29.6	27.9	42.1	25.00	198.6†	+0.5	+43.1	+38.6
EMF (MSCI)‡	1.00	1.00	1.42	na	270.3	+1.5	na	−19.0
EMBI+§	1.00	1.00	1.42	na	205.8	−0.0	na	+1.9

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus. **New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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